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EURASIAN INTEGRATION YEARBOOK

2013

Annual publication of the Eurasian Development Bank



Eurasian Development Bank

2013



Eurasian Integration Yearbook

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Edited by Evgeny Vinokurov

The Eurasian Development Bank is an international financial institution established to promote economic growth and integration processes in Eurasia. The Bank was founded by the intergovernmental agreement signed in January 2006 by the Russian Federation and the Republic of Kazakhstan. Tajikistan, Belarus, Armenia and Kyrgyzstan joined the Bank in 2009-2011. Electric power, transportation infrastructure and high-tech and innovative industries are key areas for Bank's financial activity. In line with its Charter, the Bank views economic integration in the post-Soviet space and Greater Eurasia as the top-priority of its research work.

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Edited by Evgeny Vinokurov, EDB

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List of Abbreviations

ACF – EurAsEC Anti-Crisis Fund
 ACP – African, Caribbean and Pacific countries
 ADB – Asian Development Bank
 APEC – Asian-Pacific Economic Cooperation
 ASEAN – Association of Southeast Asian Nations
 BSTDB – Black Sea Trade and Development Bank
 CA – Central Asia
 CAP – common agricultural and food policy of the SES
 CA UES – Central Asian Unified Energy System
 CDC – Coordination Dispatch Centre
 CDN – commodity distribution network
 CIF – Climate Investment Funds
 CIS – Commonwealth of Independent States
 CRRF – CSTO Collective Rapid Reaction Force
 CSTO – Collective Security Treaty Organisation
 CU – Customs Union of Russia, Belarus and Kazakhstan
 CU SCT – single customs tariff of the Customs Union
 DCFTA – deep and comprehensive free trade area
 DMA – Direct Market Access
 EAU – Eurasian Economic Union
 EBRD – European Bank for Reconstruction and Development
 EDB – Eurasian Development Bank
 EEA – European Economic Area
 EEC – European Economic Community
 EIB – European Investment Bank
 ENP – European Neighbourhood Policy
 ENRC – Eurasian Natural Resources Corporation
 ETS – Eurasian Trading System
 EU – European Union
 EurAsEC – Eurasian Economic Community
 FDI – foreign direct investment
 FEACN – Foreign Economic Activity Commodity Nomenclature
 FMS – Russian Federal Migration Service
 FSU – former Soviet Union

FTA – free trade agreement
GDP – gross domestic product
GRP – gross regional product
GTS – gas transportation system
HPP – hydropower plant
IAE CIS – International Association of Exchanges of the CIS Countries
IFC – International Finance Corporation
IFEM – integrated foreign exchange market
IMF – International Monetary Fund
IsDB – Islamic Development Bank
KTZh – Kazakhstan Temir Zholy
MDBs – multilateral development banks
Mercosur – Common Market of South America
MICEX – Moscow Interbank Currency Exchange
NAFTA – North American Free Trade Agreement
NFA – National Futures Association
NIB – Nordic Investment Bank
NPP – nuclear power plant
OECD – Organisation for Economic Cooperation and Development
OKVED – All-Russian Classifier of Types of Economic Activity
PPP – Public Private Partnership
R&D – research and development
RTS – Russian Trading System
RZD – Russian Railways
SCFP – Supply Chain Finance Programme
SCO – Shanghai Cooperation Organisation
SES – Single Economic Space of Russia, Belarus and Kazakhstan
SMEs – small and medium-sized enterprises
TFP – Trade Finance Programme
TPP – thermal power plant
UNCTAD – UN Conference on Trade and Development
UN – United Nations
VEB – Vnesheconombank
WB – World Bank
WTO – World Trade Organisation

FOREWORD

The Eurasian Development Bank is seven years old this year. It is considered a truly successful Eurasian integration project. With a cumulative investment portfolio of \$4.7 billion, comprising projects in all six member states, and \$1.7 billion equity, the Bank is a well-established financial institution with a mandate to promote investment and trade. EDB also serves regional integration by managing the EurAsEC Anti-Crisis Fund, which is endowed with \$8.5 billion.

The EDB's activities in the region are not limited to financial investments in development and integration. As a true development bank, EDB invests in rigorous and vibrant research with a focus on regional integration. We pay particular attention to providing the global audience with an overview of the quality research done by the EDB experts and our partner institutions. Hence the Eurasian Integration Yearbook, an authoritative volume which has been published by the Bank annually since 2008.

This sixth edition of the Yearbook is edited by the EDB Centre for Integration Studies, our in-house centre of excellence on regional integration issues. The Yearbook is an unprecedented source of information on both deepening and widening of Eurasian integration. In its 16 contributions this volume covers issues from the enlargement of the Customs Union to integrated commodity exchanges to labour migration. I am happy to confirm the EDB's continued commitment to research on regional integration.

Igor Finogenov

Chairman of the EDB Executive Board

Pragmatic Integration

Evgeny Vinokurov

Evgeny Vinokurov – PhD, Director of the EDB Centre for Integration Studies. He authored *A Theory of Enclaves* (2007), *The CIS, the EU, and Russia: Challenges of Integration* (2007, with K. Malfliet and L. Verpoest), *Eurasian Integration: Challenges of Transcontinental Regionalism* (2012, with A. Libman), *Holding-Together Regionalism: 20 Years of Post-Soviet Integration* (2012, with A. Libman). Editor in Chief of the *Journal of Eurasian Economic Integration* and the annual *EDB Eurasian Integration Yearbook* (six issues, 2008-2013). He published in such journals as the *Journal of Common Market Studies*, *Review of International Political Economy*, *Post-Communist Economies*, *European Urban and Regional Studies*, *Voprosy Ekonomiki*, and *Russia in Global Affairs*.

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This article systematises and defends a pragmatic approach to Eurasian integration¹.

The terms ‘Eurasia’ and ‘Eurasianism’ are very often used in Russia, Kazakhstan and other CIS countries. As a rule, they are used as a synonym for the post-Soviet space. In Russia they are also often used to emphasise an anti-Western ideology and Russia’s ‘exclusive’ way (there is no such phenomenon in Kazakhstan) (Vinokurov and Libman, 2012; Laruelle, 2008).

These approaches have a number of alternatives. Eurasia can be deemed a space for interaction between a wide range of countries on the continent, including both Europe and Asia. Russia, Kazakhstan and the CIS region as a whole could be considered to benefit most from the continental scope of integration.

It would be useful to distinguish two processes in Eurasian integration up front. The first is post-Soviet Eurasian integration – a process that has become increasingly intensive within the post-Soviet ‘regional integration core’ in recent

¹ An earlier shorter version of this paper was published in Russian in *Russia in Global Affairs*, 2013, 2(13): 49-58. The paper was substantially reworked and enlarged for the Yearbook. I am thankful to many colleagues for their comments, in particular to Vladimir Yasinskiy, Fyedor Lukyanov, Johannes Linn, and Marlene Laruelle. The author is solely responsible for the views expressed.

years. The second one concerns the processes of convergence on the continent that have become a reality in the past decades. In our understanding, Eurasian continental integration means the qualitative growth of economic, political and social ties between the regions of the Eurasian supercontinent – Europe, Northern and Central Eurasia (post-Soviet world) and Eastern, Southern and Western Asia (Linn and Tiomkin, 2006; Vinokurov and Libman, 2012 and 2013).

In this paper, I refer to both processes, first to the ‘post-Soviet’ and then to the ‘continental’ form. The particular focus is consistently placed on the interests and objectives of the current members of the Single Economic Space (SES) in properly structuring their economic and institutional integration with each other and within the Eurasian continent as a whole.

Pragmatic Eurasianism (as an overarching approach to integration to be employed by the SES members) is based on the understanding that integration is not an end in itself, but a tool for resolving the pressing problems of the states involved, whose first priority today is economic modernisation.

It is aimed at ensuring successful bottom-up integration – the free flow of goods, services, labour and capital – to guarantee the long-term stability and success of this integration project. This is a project and ideology of open regionalism, with regional governments eschewing insularity for an understanding of the necessity of integration with continental partners, both to the East and the West. There should be no place for a tendency to recreate the Soviet economic space under a different name.

Pragmatism in politics does not override the inherent ideological content. Eurasianism is an ideology. What matter is what is inside: its technocratic approach to political and managerial processes, the priority given to the economic component, and a serious approach to determining the balance of long-term benefits and losses?

As a whole, pragmatic Eurasianism comprises the following components: the understanding of integration as a tool, but not a purpose; open regionalism; the principle of subsidiarity; several states leading the process integration; the priority of economic integration; and the focus on bottom-up integration.

INTEGRATION IS NOT AN END IN ITSELF

Integration professionals such as politicians, experts and technical specialists often fall victim to an occupational hazard: they start to see integration as an end in itself.

However, economic integration processes can have both positive and negative effects. For example, international trade experts know well that trade integration can have either the effect of ‘trade creation’ or that of ‘trade diversion’, or a ‘decrease in welfare’. The latter happens when the establishment of a free trade

area or a customs union results in consumption shifting from a foreign producer with a lower cost to a domestic producer with a higher cost. In any event, the effects of integration are not necessarily intrinsically positive.

Economic and institutional integration is therefore not an end in itself, but a tool for achieving specific objectives. The entire process must be planned and managed as part of a targeted approach. For the Single Economic Space of Belarus, Kazakhstan, and Russia² as well as the entire CIS region, the objective is economic development through modernisation, spanning such aspects as attaining a more advantageous position in the international division of labour, overcoming dependency on oil and gas, and increasing industrial capacity through mutual economically beneficial cooperation. This objective governs cooperation in the area of research and engineering and, to a significant extent, in the area of education. In the social sphere, the key objective of integration is to promote stable international and interreligious peace, and a comfortable environment to support the millions of relationships between the citizens of the countries involved.

BOTTOM-UP INTEGRATION: EURASIAN INTEGRATION NEEDS TO BE ABLE TO WITHSTAND LOW OIL PRICES

The current oil prices (\$100-110 per barrel of Brent) are anomalously high in a historical perspective, even if they are recalculated in real terms. They will not remain this high forever. For this reason, developing long-term economic policies that rely on a favourable external environment is irresponsible at best and doomed to failure at worst. Planning should instead be based on the presumption that there is a probability that oil prices will fall for a prolonged period of time.

The post-Soviet economies may be divided into three groups. Group 1 comprises energy exporters: Russia, Kazakhstan, Azerbaijan and Turkmenistan. Group 2 comprises the relatively small economies of Armenia, Moldova, Kyrgyzstan and Tajikistan, which are major exporters of labour. Group 3 comprises the economies of Belarus, Uzbekistan and Ukraine, whose exports contain a significant proportion of products with a relatively high level of processing. These differences determine the adverse impact of foreign shocks on the economies in a certain group. The next global cyclical recession will affect all Eurasian countries, without exception, although there will be primary and secondary channels of influence. The oil exporters – Russia and Kazakhstan – will be the first to face the challenge of decreasing export revenues and

² A methodological note. The Custom Union (CU) forms a central part of the Single Economic Space, which also includes dozens of agreements on such issues as coordination of macroeconomic policies, access to infrastructure, common anti-trust rules, free movement of labour, etc. The SES member-states envisage moving to the Eurasian Economic Union (EAU) in 2015.

poorer access to foreign finance, which is vital for the banking system and the real sector. The exporters of labour will face a decrease in money transferred by labour migrants working in Russia and Kazakhstan. The countries in the third group will suffer from both an external demand shock and prohibitively expensive foreign borrowings. Therefore, everyone will be affected (EDB Centre for Integration Studies, 2012b).

A fall in oil prices would destabilise the region's leading countries and would result, at best, in their loss of interest in integration. It has to do with at least three reasons: first, the diminishing attractiveness of the Russian market, second, rising protectionism, and, third, the level of transfers in the union. If protectionism evolves in response to a crisis, will it be possible to mitigate it within the framework of the Customs Union? Will it be possible to preserve the level of integration achieved without a system of transfers between more or less successful members? When export revenues and economic activity decrease sharply, the countries involved will lack resources to provide external assistance to others. In addition, offering financial assistance for foreign partners will be very unpopular from a political point of view.

With respect to Eurasian integration, the question takes the form of a conventional stress test: Could Eurasian integration withstand a price of \$80 per barrel for an extended period of time? What about \$60?

There is no panacea. However, it is clear that the long-term sustainability of integration processes could be ensured by lively and successful bottom-up integration – the mutually beneficial flows of goods, services, labour and capital. In the first place, these are investment flows and labour migration. Trans-border companies and holdings that own intertwined assets in a number of countries of the future Eurasian Union would become an important stability factor. Such projects have the potential to be problematic (consider the regular Franco-German squabbles around the EADS), but they form the skeleton of long-term economic integration capable of surviving a crisis.

GENERAL INDUSTRIAL, RESEARCH AND TECHNOLOGICAL POLICIES

Long-term economic growth depends on the technological leadership, at least in some important areas. If a country has failed to find its technological niche, it will be at a disadvantage when mastering new technologies and will have to content itself with lower added value. The integration of markets, resources and assets has two advantages in this regard: first, a broader domestic market creates favourable conditions for achieving economies of scale; and, second, closer technological ties provide additional capabilities necessary to succeed in the technological race.

President of Kazakhstan, Nursultan Nazarbayev, voiced this sentiment as early as 1994: “[...] The development of the post-Soviet space today has two tendencies. The first is the formation of nationhood and the second is

integration of the CIS countries. This is logical. In the context of the exuberant scientific and technological progress and a tough fight for markets, survival is only possible through integration. Consider Western European countries with their centuries-long nationhood, which are moving towards integration. They understand perfectly that the global market is becoming strongly polarised [...]” (Nazarbayev, 1994).

The objective economic needs of the SES attach an increasingly important role to the advancement of the industrial sector in the member economies of the integrated union. Industry needs to be revived as the driver of the economy. The respective policy should factor in not only the demand of separate countries for cutting-edge, quality industrial products, but the needs of the member countries of the integrated union and their export potential (EDB Centre for Integration Studies, 2013a). This means not the conventional industrial policy of indicative planning, but the promotion of growth, support for competition and the establishment of rules that would attract both domestic and foreign investment.

At present, for the first time in the past twenty years, there are favourable preconditions in place to devise a comprehensive and coordinated programme for long-term economic development and improved competitiveness, both on the national level and for the SES as a whole. In this context we should speak of a combination of “a single trade policy + a coordinated industrial policy + a coordinated scientific and technological policy” for the member states.

TRANSBORDER COMPANIES AND HOLDINGS

Mutual investment by and into transborder companies and holdings in particular should be one of the key drivers of stable and successful Eurasian integration.

An expedient approach seems to be the promotion of cooperation, including mergers and acquisitions, with SES producers making a consolidated entrance onto the global market. Transnational companies and holdings generally develop in sectors in which member states have real potential for global leadership, and the combination of strengths has a synergy effect, furthering their potential. Transnational companies are usually established in technologically advanced sectors. Accordingly, they become an instrument of technological convergence and modernisation.

Transnational companies (jointly owned either by government or, preferably, by private parties from the member states) should be set up in areas that already offer comparative and/or competitive advantages or have serious potential for developing them. The post-Soviet space has some ten to twelve such sectors, which are, in essence, breakthrough points, apart from the oil and gas sector (a definitive list may be disputable). These include ferrous and non-ferrous metallurgy, coke chemistry, fertilisers, power engineering, rail engineering, heavy automobile construction, aircraft and helicopter engineering, the space industry

and agriculture, in particular the grain sector. In particular, the development of 'Eurasian champions' needs to be supported in those breakthrough industries where the structure of the global market does not permit them to evolve without the state support.

A joint 'Eurasian champion' should have ambitious objectives such as, for example, those for the potential Russian-Ukrainian helicopter holding – "deep modernisation, new niches and an increase in global market share from 17% to 30% by 2030" or, those of the Kazakh-Russian nuclear power holding – "to be represented at all stages of the nuclear fuel cycle, to outpace Areva, Cameco and Toshiba and to become no. 1 supplier of goods and services of the nuclear fuel cycle on the global market by 2030." These grand objectives should be accompanied by additional capitalisation, R&D financing, and (possibly, most important) the financing of relevant professional education.

THE PRINCIPLE OF SUBSIDIARITY

The principle of subsidiarity, which underlies American federalism and European integration, is applicable to Eurasian integration as well.

According to this principle, tasks should be resolved at the lowest level where they can be dealt with effectively. Authority and financial resources are distributed in the same fashion. A set of criteria is used to prove the compliance of the proposed measures with the principle of subsidiarity. The first criterion is the proximity of the government to citizens. The second criterion is sufficiency. Can objectives be achieved to a sufficient extent at lower levels? The third is benefit. Will the resolution of a task at a higher level be more effective or beneficial?

In accordance with the principle of subsidiarity, the only tasks that should be raised to the supranational level are those that either need to be resolved at this level by definition (for example, a single foreign trade policy or single technical regulations for a common market) or whose solution at this level would be significantly more efficient. The principle of subsidiarity is particularly relevant to institutional integration.

This principle is not easy to apply in a consistent and convincing manner (there is a constant battle in the EU about this). Nevertheless, it serves well as a general guideline in how competencies should be allocated.

IMPORTANCE OF SOCIAL AND CULTURAL INTEGRATION

Integration is not limited to the economy. In addition to the economy, there are also security issues (including soft security) as well as various social and cultural issues. In fact, they are comparable, in terms of their long-term societal importance, with economic achievements. The social and cultural aspects include family ties, permanent and temporary migration, educational links,

tourism, the exchange of values and many other positive cultural aspects. Integration strengthens international and interreligious peace, not only in international relationships but within the countries involved as well.

The effects of social integration are, to a significant extent, intangible and so are difficult (or even impossible) to quantify. However, their importance must not be underestimated. For example, the recent launch of the Astana–Omsk flight could be more important in practice to the people living in the Omsk and Akmola regions than an abstract growth of trade flows. Whereas, previously, one had to take an eleven-hour train ride, now it is possible to get to the other city in slightly more than an hour. Such measures simplify trade and investment cooperation, family ties, tourism, and educational exchanges.

The Russian language plays a huge role as a means of integration. Research shows that the use of a common language has a positive effect on the intensity of trade and investment relationships. The Russian language as a lingua franca is currently under threat in many part of the post-Soviet space. Even despite a hugely beneficial impact of labour migration, there is a serious risk that the next generation will not be able to communicate with each other in Russian. Thus, the measures to preserve the Russian language as a medium of international communication in the region will be highly profitable in a comprehensive sense of the word. Language and cultural networks such as the Pushkin Institute are a good investment in the future.

Strengthening educational ties – from school, student, postgraduate and academic exchanges, to the harmonisation of curricula and the mutual recognition of graduation certificates – is a key instrument of long-term integration. A programme of mass school, university, postgraduate and academic exchanges, which would be similar to, for example, Europe's Erasmus Mundus programme, still needs to be developed and launched. Such a programme could be named after Shoqan Walikhanov, a Kazakh researcher, historian, and ethnographer who studied in Omsk. It could be structured as a system of grants which would cover, in full or in part, the expenses for studying abroad for one or two semesters. The primary task is to make the programme a large-scale one, with an annual intake of tens of thousands of students.

EURASIANISM AS A PROJECT AND IDEOLOGY OF OPEN REGIONALISM

Pragmatic Eurasianism requires that a long-term balance of costs and benefits be taken into account during discussion and implementation of integration measures. Both components of the balance are extensive and the long-run planning horizon makes it possible to factor in multiple effects, not necessarily those of a purely economic nature. That does not mean, however, that Eurasian integration should be a purely 'accounting' process. Even if the discussion of the future of Eurasian integration is consciously framed in a pragmatic and

technocratic context, Eurasianism remains an ideology. The question is what kind of ideology it is.

The Eurasian idea is often understood as an alternative to, as a minimum, Russia and other post-Soviet countries' European orientation or, as a maximum, a synonym of Russia's 'unique way'. As it is known, the ideas of Eurasianism were born in the 1920s, although their roots can be traced to 19th-century Russian intellectuals' search for identity. This kind of Eurasian ideology was elaborated by Russian emigrants – unfortunate, suffering people who believed in the grandeur of their homeland but were forced to depart and watch its agony from exile. Eurasianism's evolution still remains complicated, its development hindered by both real and contrived nostalgia for the Soviet past.

The formation of a constructive and productive Eurasian ideology for the SES member states could be based on a number of aspects.

First, post-Soviet Eurasian integration should remain focused on the economy. The combination of the Customs Union (the common customs area) and the SES (dozens of agreements that set forth the basics of the common economic rules or, in essence, the common Eurasian market) is a healthy foundation.

Second, it is very desirable that Russia should not become the only driver of integration. "Eurasia is not a synonym for Russia" (Nysanbayev, Kurmanbayev, 1999). Despite Russia's apparent weight as the region's largest economy, the Eurasian project or, at least, its political dimension, should not be a Russian-centric phenomenon. Other drivers and active players are needed. In this context, the maintenance of Kazakhstan's proactive position is of critical importance.

Third, post-Soviet Eurasian integration should not become introverted or aim to restore the unity of the post-Soviet space in any fashion. Certainly, the potential for economic and technological convergence in the post-Soviet world is significant (EDB Centre for Integration Studies, 2012a, provides comprehensive assessment of economic impact), but it is limited. Eurasian continental integration would be a logical step forward. Deeper economic integration, both westward (with the Eurasian Union) and eastward (with China, South Korea, Japan, Southeast Asia) and southward (Turkey and, to a lesser extent due to economic geography, India and the Gulf states), could bring about multiple benefits. The range of potentially profitable areas includes a common trade regime, the harmonisation of technical standards, the infrastructure of hydrocarbon exports, rail and car transport, the industrialisation of transport, land telecommunications, regional and subregional common electricity markets, cooperation between bordering regions, visa-free travel between certain countries, educational exchange and many other things.

These principles in the aggregate are aimed at developing open regionalism in Eurasia, where the post-Soviet countries will become simultaneously the drivers, the backbone and the key beneficiaries of the process.

This paradigm makes it possible to apply another approach to some important aspects of integration, in particular the role of Ukraine.

THE UKRAINIAN ISSUE

There is hardly another issue that involves as many clichés and such a degree of politicisation as 'Ukraine's civilisational choice.' Unfortunately, the discussions of Ukraine's future usually take an 'either/or' format and are in danger of descending into emotional back-and-forth arguments of the relative merits of identity with Europe or with Russia³. It does not have to be like this: the paradigm of continental integration makes it possible to apply a 'both/and' approach.

The post-Soviet space and the EU often demonstrate a deep misunderstanding of the essence of each other's integration processes. On the whole, Europe and the West tend to perceive the CIS and, recently, the SES as products of 'Russian imperialism.' However, the post-Soviet integration project has a vital economic dimension which is expected to produce considerable benefits for the member states. It seems to be difficult for Europeans to understand the depth of cooperation ties that have been inherited by post-Soviet countries from the Soviet Union, and the vital importance of these ties for the modernisation of the economies of Russia, Ukraine, Kazakhstan and Belarus. There has been no precedent for a similar breakdown in the world, except, possibly, the breakdown of Austria-Hungary. It is not difficult to model, though. Imagine a breakdown of the European Union (not only the currency zone but the entire common market). Now imagine all the incentives for Europe's reintegration in this case. And now triple the result, because the Soviet economy was much more intertwined than the economy of today's European Union is (for a comprehensive economic analysis of the costs of disintegration of the Soviet Union, see Linn 2004; based on his analysis, Linn concludes that the principal focus of reintegration should be on lowering barriers to internal trade and transit and to internal mobility of labour, capital and knowledge within the region, while at the same time aiming at integration of the region with the rest of the world)⁴.

³ We should also state quite clearly: the EU membership is not on the table as a viable alternative nor will it be in the long-term future. Turkey can readily provide a lesson or two in this regard. The choice is currently framed as 'Association agreement with the EU vs. the full membership in the Eurasian Economic Union'.

⁴ For a comprehensive economic analysis of the costs of disintegration of the Soviet Union, see Linn 2004. Linn concludes that the principal focus of reintegration should be on lowering barriers to internal trade and transit and to internal mobility of labour, capital and knowledge within the region, while at the same time aiming at integration of the region with the rest of the world.

The most important point is that European and post-Soviet integration should not be deemed mutually exclusive. On the contrary, CIS regionalism could become a step towards integration with the European Union. The Customs Union of Belarus, Kazakhstan and Russia could be a more effective and strong partner for the EU than separate countries. In particular, this would give additional incentives for extending dialogue on mutual infrastructure and partial adaptation of European norms and standards.

At present, Ukraine – located between the European Union and the Customs Union – is overwhelmed with discussion on its possible entry to one of these communities. However, let us ask ourselves: would Ukraine's European orientation make integration with Russia and its partners impossible? Russia gravitates towards Europe as concerns trade and investment flows, the distribution of population, and cultural preferences. Kazakhstan is also a 'European' country: the EU is its largest trade partner (37.7% of exports and 32.3% of foreign trade in 2010, according to the IMF); Kazakh companies are listed on the London Stock Exchange. The winners of the Bolashak governmental programme for students prefer to study in Europe. Up to 50% of the Bolashak winners studied in Europe, compared with 5% in East and Southeast Asia (plus 28% in the United States and 9% in Russia)⁵.

It seems that the optimal long-term solution to the 'Ukrainian issue' can be found in economic integration both with the EU and the EAU in various forms. A strong option would be to include Ukraine in the CU and then sign a deep and comprehensive free trade agreement (DCFTA) between the post-Soviet trade bloc (with a population of approximately 220 million and GDP of \$2.2 trillion) and the European Union. In this scenario, Ukraine would achieve all its objectives by ensuring favourable relationships with Russia and other partners in Northern and Central Eurasia, and at the same time strengthening its own European choice. Such an agreement would become a universal basis for legislative convergence and, ultimately, the adoption of a visa-free regime. Another option is to make a DCFTA (or a set of agreements) between the triangle of the EU, Ukraine and the CU. In any case, the agreement should obviously be a comprehensive solution governing not only trade, but the free movement of people (visa-free regime) and capital, the gradual unification of technical standards and the integration of infrastructure as well.

One way or another, an optimal solution to including Ukraine in Greater Eurasia is possible only with the participation of both the EU and the CU. The European Union does not deny in principle the possibility of cooperation with economic blocs: in 2010 it renewed negotiations on free trade with Mercosur (the Southern American common market). The very modest results of the EU's

⁵ Calculated by the author based on the data from the Centre for International Programmes (<http://edu-cip.kz/Media/Default/HtmlWidget/Articles/statistika2012new.pdf>). Aggregate data for 1994-2011.

current Eastern Neighbourhood policy should also be considered. It is time to think about deep changes in conceptual approaches on both sides.

EURASIAN PARTNERSHIP PROGRAMME: FLEXIBILITY AND DIVERSITY OF TOOLS

Eurasia is not limited to the post-Soviet space. The geographical boundaries of the integration project should not be deemed to have been finally determined by its Soviet past. If in some respects the post-Soviet space could really be the optimal region for integration, in other instances other combinations of countries would be more advantageous.

The new reality calls for new tools of constructive cooperation with neighbouring partners in the CIS and the Eurasian continent as a whole. To develop multilateral cooperation, the SES and the future Eurasian Economic Union could launch a programme with a working title of Eurasian Partnership, which would promote deeper integration with neighbouring countries (EDB Centre for Integration Studies, 2013b). The Eurasian Partnership could encompass both bilateral and multilateral cooperation. However, it should focus on bilateral arrangements that would factor in the specifics of each of the partners. This cooperation could be governed not only by agreements, but by joint plans of action (as in the European Neighbourhood Policy) and participation in joint programmes.

The objective of the Eurasian Partnership Programme will be to ensure deeper trade and economic cooperation between the countries of Northern and Central Eurasia and, in the future, with other strategic partners in Eurasia without obligatory membership to the SES. The format could be similar to that of the Euro-Mediterranean Partnership: the SES could interact with a partner country with the objective of both including it as a member of the SES and establishing the shortest possible distance in cooperation. The "Eurasian partnership" could become a fundamental basis for cooperation between various countries and the SES, with the interests of all parties taken into account.

CONCLUSION

In conclusion, let us summarise some points about pragmatic Eurasianism described in this article:

- Economic integration is not an end in itself, but a tool for resolving fundamental tasks faced by the member countries: economic modernisation, the achievement of an optimal position in the international division of labour, and the achievement of international and interreligious peace in the region. In doing so, there should be no place for a tendency to recreate the Soviet economic space under a different name.
- For the post-Soviet Eurasian integration to have a future, it should be able to withstand crises and, in the first place, a possible long-term decrease in oil prices. Long-term stability could be ensured by lively and successful

bottom-up integration: intensive and mutually beneficial flows of goods, services, labour and capital (investment flows and labour migration in the first place). Transborder companies and holdings that own intertwined assets in a number of countries of the future Eurasian Economic Union could become one of the most important guarantees of stability.

- The objectives of economic modernisation and the improvement of competitiveness of the SES countries require that a number of common policies be adopted, including a combination of “a single trade policy + a coordinated industrial policy + a coordinated scientific and technological policy.”
- The principle of subsidiarity is part of the overall pragmatic approach to building regional integration institutes.
- Integration and international cooperation embrace at least three very important areas of interstate and international cooperation: economy, security and social and cultural ties. Investments in the social and cultural sphere, such as educational cooperation or support of the Russian language, are necessary and could be very profitable in the long run. However, a pragmatic approach emphasises the priority of economy as the foundation of integration.
- The geographical boundaries of the post-Soviet integration project should not be deemed to have been determined by the Soviet past forever. Eurasian continental integration is a flexible and pragmatic approach to uniting in western and eastern directions, in which post-Soviet countries can become simultaneously the driver, the backbone element and key beneficiaries.

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Eurasian Partnership: Potential Instruments for External Relations of the Eurasian Economic Union

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This article reviews opportunities for furthering integrative cooperation between Eurasian economies, specifically Armenia, Moldova and Tajikistan, and the Customs Union (CU), Single Economic Space (SES) and future Eurasian Economic Union (EAU). Such cooperation should not be based only on a necessary membership of these countries in the Union, but must be flexible¹. We analyse global practice of cooperation between remote economies and major integrative alliances, and identify several major types of cooperation. We also review opportunities to improve the competitiveness of Armenia, Moldova and Tajikistan regarding the CU and SES based on analysis of their comparative advantages and their profile in the context of trade and economic cooperation with the CU.

In 2010, Russia, Belarus and Kazakhstan set up the Customs Union, based on which the Single Economic Space, has been under development since 2012.

¹ The views outlined in this article do not necessary represent or reflect the position of the Eurasian Development Bank.

The Eurasian Economic Union (EAU, based on the CU and SES legal framework), is expected to be established by 2015, and the relevant international treaty signed. It is essential for the SES and other organisations to elaborate methods and instruments for effective economic interaction with partner states, both within and outside the CIS region.

The opportunities provided by the common market of the CU-SES and emerging EAU will affect the key interests of some countries which are not members of the above alliances, including some with no common borders with the common customs area, and some comparable in economic size and/or structure to the member states. Armenia, Moldova and Tajikistan therefore stand out as the most salient examples. They are all involved in the Eurasian Economic Community (EurAsEC), Armenia and Moldova being associated members; however, due to their physical remoteness from the CU-SES there are no short- or medium-term plans for them to fully join these alliances.

The importance for these three countries of devising ways to cooperate with the CU-SES and EAU is dictated by their close economic ties with Russia, Kazakhstan and Belarus, and their need to increase economic competitiveness. The creation of the CU and SES has imposed new conditions on these countries: they face increasingly challenging and intense competition on their conventional separate external markets of Russia, Belarus and Kazakhstan. Armenia, Moldova and Tajikistan need to find efficient ways to deepen regional cooperation and hence to improve their economic competitiveness under these new conditions.

In this day and age, the issue of cooperation between major integrative alliances and their neighbouring countries is not limited to a binary choice between accession and non-accession to existing economic unions. Different countries may be offered differing cooperation formats depending upon their economic structure, taking into account the comparative advantages and interests of the parties. The integration of the CU of Belarus, Kazakhstan and Russia and the SES with Armenia, Moldova and Tajikistan is no exception to this rule. Each of the above economies has its own characteristics, and represents different business interests to the CU member states, and so different cooperation models may therefore be offered to each. This article identifies potential options for cooperation with the CU and SES based on analysis of the current situation, the trade and economic interests of Armenia, Moldova, Tajikistan and the member states of the CU-SES, and world practice.

The three countries above share some key features: a limited domestic market, land-locked location, low density economic activity, long distance to major markets and significant economic disconnection between trade partners and major markets. Stable cooperation with the CU-SES would facilitate market expansion and economic modernisation.

A meaningful review of potential cooperation between Armenia, Moldova and Tajikistan and the CU-SES requires account of both the salient trade and economic characteristics of these countries and common international practice of cooperation between major integrative alliances and neighbouring economies. All this, together with the stated objective, determines the structure of the present article, based on the corresponding report, Customs Union and Neighbouring Countries: Models and Instruments of Mutually Beneficial Partnership, by the Centre for Integration Studies of the Eurasian Development Bank (EDB) and the Gaidar Institute for Economic Policies (EDB, 2013a). The complete Russian version of the report contains a full description of the methodology and references².

Firstly, this article provides an analysis of global experience relating to forms of cooperation between remote economies and major integrative alliances, and identifies several major types of cooperation. Secondly, trade and economic characteristics of Armenia, Moldova and Tajikistan are reviewed, and their economic competitiveness regarding the countries of the CU is analysed using various quantitative characteristics. We identify the comparative advantages of different economic sectors, and analyse the investment opportunities and business climate of these countries. Thirdly, potential areas and ways for furthering cooperation and integrative interaction between Armenia, Moldova and Tajikistan and the CU-SES are outlined with due consideration of the specifics of each country. In addition, this article outlines proposals for developing the Eurasian Partnership, a SES and future EAU programme. The main findings and recommendations arising from that study are outlined in the conclusions.

It is important to agree on the terminology used in this article as there are multiple approaches to it (Beeson (2007); Hettne, Soederbaum (2000); Hurrell (1995); Kaplan (1957); Zhuravskaya (1990)). In the second half of the 20th century, the term 'integration' started to be used to mean different forms of interstate regional and sub-regional cooperation dictated by common interests in specific areas. We believe it necessary to differentiate between the concept of bilateral and multinational cooperation which implies and requires no supranational and regional administration, and therefore is unsustainable and unpredictable, and the concept of integration which can evolve effectively through setting up relevant supranational administration centres and programmes implemented by such centres. The states involved in such integration interact under programmes based on clear phases, forms and tactical and strategic objectives. It is necessary to mention the term regionalism, which is often understood as a set of deliberate actions of states in a region aiming to coordinate their policies and build relevant

² Complete Russian version, English executive summary and presentation are available online at www.eabr.org. That report serves as a source of all figures in this paper, if not mentioned otherwise. We also use further monographs and relevant articles (Vinokurov, Libman, 2012a; Vinokurov, Libman, 2012b; Vinokurov, 2013) to supplement data and arguments.

common institutions. This term is synonymous with the concept of integration, i.e. a process of convergence across states through intensive interaction, also defined as the objective of this process.

This study treats integration primarily as a process of market integration within a specific group of countries of the former Soviet Union (FSU), although, in the mid- and long-term the process is not necessarily limited to this region, as other countries of the Eurasian continent may also be interested in participating in Eurasian integration processes (Vinokurov, Libman, 2012a). Geographically, FSU countries are located in Northern and Central Eurasia; therefore, there is an established practice in academic discourse of referring to integrative interaction among FSU countries as ‘Eurasian integration’. This principle is also retained in this article.

Here the FSU is understood as the entire area of the former Soviet Union, excluding the Baltic countries, which are European Union member states. This term is the most frequently used for this concept, including by international expert communities. In addition, a clarifying term of ‘CIS region’ is also used in this study, although it is not linked to the Commonwealth of Independent States as an interstate institution, because Georgia, for instance, is no longer part of this organisation although it geographically belongs to the region. This region is also often referred to as the ‘Eurasian (Economic) Space’.

Finally, a word about the acronym for the Eurasian Economic Union: current discussions on establishing a consistent abbreviation mostly use three alternative acronyms: EEU, EAEU, and EAU. The point is that in Russian the first variant (ЕЭС or ЕЕУ) sounds similar to the acronyms of the corresponding institutions of European integration, in particular, the European Economic Community (EEC) or European Economic Area (EEA). The second variant (EAEU) is difficult to pronounce and is not appealing in English, also resembling the acronym for the European Union (EU).

In our view, the acronym of EAU is the best option (EDB, 2013b), both in Russian (ЕЭС) and English (EAU), from the standpoint of originality and also positioning in the world. The acronym of EAU is aligned with the future potential transformation of the Eurasian Economic Union into the Eurasian Union, especially given that the word ‘economic’ is sometimes dropped from the name in discourse, and inconsistencies and the possible need for rebranding are best avoided from the start.

TRADE AND ECONOMIC COOPERATION BETWEEN MAJOR INTEGRATIVE ASSOCIATIONS AND REMOTE ECONOMIES: INTERNATIONAL PRACTICE

As integration processes expand across the world, it is increasingly important for remote economies to improve their competitiveness through cooperation with major integrative alliances.

There are many examples of cooperation between countries and major regional integrative alliances that do not involve formal membership, which can be explained by the specific interests of the countries involved. In this section we focus on the European Union's cooperation with other countries. For convenience, we have identified six basic models of cooperation between the EU and remote non-member economies:

- 1) The model of cooperation between the EU, Norway and Iceland as part of the European Economic Zone;
 - 2) The model of cooperation between the EU and Switzerland;
 - 3) The model of cooperation between the EU and countries of Eastern Europe and the South Caucasus;
 - 4) The model of cooperation between the EU and Mediterranean countries;
 - 5) The model of cooperation between the EU and Balkan countries;
 - 6) The model of cooperation between the EU and African, Caribbean and Pacific countries (ACP).
- The model of cooperation between the EU, Norway and Iceland implies signature of a comprehensive EEA Agreement given Norway and Iceland's specific interests in fisheries and agriculture (Emerson et al., 2002; Ghouas, 2004; Babybina, 2010).
 - The model of cooperation between the EU and Switzerland implies signature of a number of bilateral sector agreements given Switzerland's specific interests in the banking sector, with no overarching framework agreement (Grolimund, Vahl, 2006; Buehler et al., 2011; Petrov, 2011).
 - The model of cooperation between the EU and countries of Eastern Europe and South Caucasus implies signature of partnership and cooperation agreements that are subsequently transformed into European Neighbourhood Policy (ENP) Action Plans (Noutcheva, Emerson, 2005; Vahl, 2005), supplemented by the EU Eastern Partnership Programme focusing on the countries of the CIS region (Arutyunyan, Sergunin, 2012). The establishment of deep and comprehensive free trade areas (DCFTA) under bilateral association agreements between the EU and partner countries is under consideration, with negotiations with some countries currently underway (Messerlin et al., 2011). This network of bilateral agreements may morph into the European Neighbourhood Economic Community; however, there is no guarantee that these countries will be integrated into the EU.
 - The model of cooperation between the EU and Mediterranean countries includes agreements on the EU-Mediterranean Association, ENP Action Plans and the Union for the Mediterranean. There has been noticeable

movement from both sides to create a comprehensive EU-Mediterranean free trade association (Vahl, 2005; Emerson, 2007; Trofimova, 2011).

- The model of cooperation between the EU and Balkan countries implies a process of stabilisation and signature of bilateral free trade agreements (FTAs), displaying a state of disequilibrium that over the long term should evolve into either cooperation with no membership or full membership (Demetropoulou, 2002; Vahl, 2005; Emerson, 2007).
- The model of cooperation between the EU and the ACP countries includes the transition from the trade preference regime of the former colonies to economic cooperation agreements based on WTO principles through signature of agreements and establishment of free trade areas with long transition periods (Busse et al., 2004).

The complete version of the above report (EDB, 2013) contains full information on the forms and instruments of cooperation between remote economies and major integrative alliances. It should be noted here that the study also includes analysis of such alliances as the Common Market of the South (Mercosur), the North American Free Trade Agreement (NAFTA), Asian-Pacific Economic Cooperation (APEC), and the Association of Southeast Asian Nations (ASEAN). The models of cooperation between these integrative associations and partners, however, to some extent replicate the elements of the relevant EU models. For instance, Chile is an associated Mercosur member through its participation in the Mercosur free trade area, but it is not a member of the Mercosur Customs Union, where the common external tariff is higher than the tariffs in Chile. Negotiations are also underway for Chile to join NAFTA, whereby Chile has an FTA with each individual NAFTA member. As we can see, the model of Chilean cooperation with Mercosur is similar to the model of cooperation between the EU and Norway and Iceland, and the model of cooperation between the EU and the Mediterranean countries. The key models of EU integrative interaction are summarised in the table below.

Thus, in the modern context, the issue of cooperation between major integrative alliances and neighbouring states is not limited to a binary choice between accession and non-accession to the existing economic unions. Different countries may be offered various cooperation formats depending upon their economic structure, and the comparative strengths and interests of the parties.

Model of cooperation	Countries	Comments
1. Model of cooperation among the EU, Norway and Iceland: European Economic Area Agreement (EEA);	Norway	Norway participates in the EU common market via the EEA, and the Schengen Area. Most laws and regulations related to the EU common market are already followed in Norway. Special interests in fisheries and agriculture.
	Iceland	Iceland participates in the EU common market via the EEA, and the Schengen Area. Iceland has the status of a candidate country for EU accession (filed its application in 2009). Previously, the process was slowed down by fishing quotas, the main economic sector of the country, whereas now Iceland anticipates concessions from the EU.
2. Model of cooperation between the EU and Switzerland: bilateral sectoral agreements.	Switzerland	Switzerland has bilateral sectoral agreements with the EU envisaging harmonisation of the Swiss legal framework with EU legislation. Exceptions: Swiss banks retained the right to keep information on national tax evasion by their clients confidential. Participates in the Schengen Area.
3. Model of cooperation between the EU and countries of Eastern Europe and the South Caucasus: partnership and cooperation agreements, European Neighbourhood Policy (ENP) Action Plans, EU Eastern Partnership programme.	Azerbaijan, Armenia, Belarus, Georgia, Moldova, Ukraine	Partnership and cooperation agreements between the EU and countries of the CIS region, ENP Action Plans supplemented by the Eastern Partnership programme. Bilateral Association Agreements between EU and partner countries provide for future establishment of DCFTAs and phased integration of these countries into the European social, economic and political space. The bilateral agreements may evolve into a Neighbourhood Economic Community with no guarantee of EU membership.
4. Model of cooperation between the EU and Mediterranean countries: agreements on EU-Mediterranean Association, European Neighbourhood Policy Action Plans.	Tunisia	The EU-Mediterranean Agreement establishing an association between the EU and Tunisia became effective in 1998, and ENP Action Plan was adopted in July 2005.
	Morocco	The EU-Mediterranean Agreement establishing an association between the EU and Morocco was signed in 2000, and the ENP Action Plan for Morocco was adopted in July 2005. It has "advanced status", which is an intermediate stage between associated membership and the possibility of becoming candidate for EU accession.
	Israel	The EU-Mediterranean Agreement establishing an association between the EU and Israel was signed in 1995, and the ENP Action Plan for Israel was adopted in July 2004.
5. Model of cooperation between the EU and Balkan countries: uneven format on the way to full accession.	Croatia has completed the negotiations on EU accession.	State of disequilibrium which over the long term may evolve into either cooperation with no membership or full membership. EU Stabilisation and Association Agreements have been implemented with the Balkan countries as a step towards EU accession. The EU has also implemented FTAs with various Balkan countries, e.g. EU-Croatia (2002-2003); EU-Macedonia (2002-2003); EU-Bosnia and Herzegovina (2008); EU-Montenegro (2008-2009); EU-Serbia (2010).
6. Model of transition from the regime of trade preferences for the former colonies to signing economic cooperation agreements.	The EU and African, Caribbean and Pacific countries	Implementation of a phased transition from the regime of trade preferences for the former colonies to trade regimes based on WTO principles by signature of economic cooperation agreements and establishment of an FTA in the long run with a long transition period.

ALTERNATIVE PATHS FOR IMPROVING THE ECONOMIC COMPETITIVENESS OF ARMENIA, MOLDOVA AND TAJIKISTAN REGARDING THE EU AND SES

Trade and economic relations between and among FSU countries often develop from existing close ties that were established in the planned economy of the Soviet period. Local exporters are better aware of the opportunities for trade with Russia and other FSU countries due to similarities in law, language and mentality (Guiso et al., 2009). There may be further potential for beneficial trade and economic relationships with other countries, which is currently unrealised due to the individual countries' reluctance to investigate (Campbell, 2010). The existing trade between FSU countries exceeds the trade projected by different empirical models, whereas trade with the rest of the world is lower than that predicted by the models (Langhammer, Lucke, 1995). Even now, Armenia, Moldova and Tajikistan, although not CU members, have larger volumes of trade with Russia than should be expected from economic theory (Babecky et al., 2010).

The issue at stake is not the volume of goods traded, but their value. Although Armenia, Moldova and Tajikistan have large volumes of foreign trade, these countries may increase the value of their trade by improving their competitiveness through cooperation with the CU.

In an open economy, domestic production usually increases when domestic producers can compete with foreign ones. Such competition implies that domestic producers offer either quality produce at relatively low prices or unique produce that is in high demand on domestic and international markets.

Countries' relative competitiveness in different sectors may be evaluated in different ways. Identification of these comparative advantages helps to determine the pros and cons of various forms of integration.

In this study, the comparative advantages of Armenia, Moldova and Tajikistan are determined based on five variations of the comparative advantage index³. A review of the estimated competitiveness of these countries regarding the Customs Union in major commodity groups showed the following^{4, 5}:

The results indicate that Armenia has a slight comparative advantage over the CU in agriculture; however, it has no comparative advantage in the mineral production, chemical or woodworking industries. Moldova, in its turn, has a comparative advantage in agriculture and other sectors.

³ Estimations are based on the trade data of the UN Comtrade, <http://comtrade.un.org/>

⁴ The authors used methods for estimating the revealed comparative advantages as described by Liesner (1958); Balassa (1977) and Greenaway, Milner (1993). Tables with findings are given in the appendix.

⁵ See exact distribution of commodities within the groups under review in the appendix.

Armenia, Moldova and Tajikistan have certain resources for increasing their exports of minerals (copper, molybdenum, and gold in Armenia) and agricultural products (wine and cotton in Moldova and Tajikistan), although these resources are not large enough to become primary drivers of economic growth.

The low competitiveness of goods from Armenia and Moldova is mainly determined by the similarity of their export patterns with those of the CU member states (see Table 2.1).

Table 2.1.
Export Pattern
Similarity Index⁶:
Armenia, Moldova
and Tajikistan and
the Customs Union
Member States

Source: UN
Comtrade, 2011⁷:
<http://comtrade.un.org/>, authors'
calculations

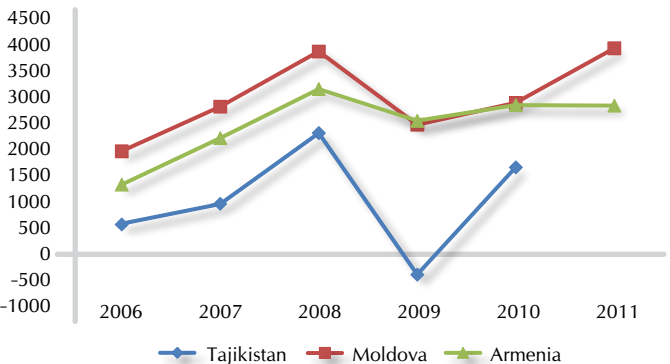
Countries as trade partners	Export Pattern Similarity Index
CU-Armenia	18%
CU-Moldova	19%
CU-Tajikistan	15%

It should be noted that for many macroeconomic indicators Moldova has values close to those of the Russian Federation, for example, real GDP growth rate; volatility of bilateral exchange rate and volatility of consumer price index growth rate⁸.

Figure 2.1 shows that significant negative balances of trade and current transactions are characteristic for these countries. Thus, due to low taxes on raw

Figure 2.1.
Trade Balance
Deficit: Armenia,
Moldova and
Tajikistan

Source: UN
Comtrade for
Armenia and
Moldova⁹ <http://comtrade.un.org/>;
International Trade
Centre for Tajikistan:
<http://www.trademap.org/>;
authors' calculations



⁶ See Roth, 2011 for index description.

⁷ Data for Tajikistan is given for 2010

⁸ Calculations are based on the following databases: IMF Database, International Financial Statistics (IFS), URL: <http://www.imf.org/external/data.htm>; World Bank Group Database (World Data bank) URL: <http://data.worldbank.org/>; UN Statistics, URL: <http://unstats.un.org/>; CIS Statistical Committee, URL: <http://cisstat.com>;

⁹ Data for Tajikistan is given for 2010

material exports, the tax base in these countries primarily consists of domestic economic activities, on which taxation is more complicated (EDB, 2012). Consequently, the budgets of these countries are chronically deficit-ridden and often depend upon external financing: from the EU in Moldova’s case, or people working abroad (all three countries).

Among indices demonstrating the competitiveness of a country’s exports, the Trade Performance Index calculated by the International Trade Centre should be specifically mentioned¹⁰.

The tables in the appendix demonstrate that Armenia is, to some extent, competitive in mineral exports, as compared with other exports. This is slightly misleading since this competitiveness is exclusively due to Armenia’s great variety of mineral products, whereas source sites are few and are poorly maintained.

The most competitive sector in Tajikistan is textiles, which is to a great extent achieved through a wide range of export destinations.

Armenia, Tajikistan and Moldova have lower rankings in the Global Competitiveness Index than the CU and SES countries, proving that domestic producers cannot compete with firms from the CU countries (see Figure 2.2).

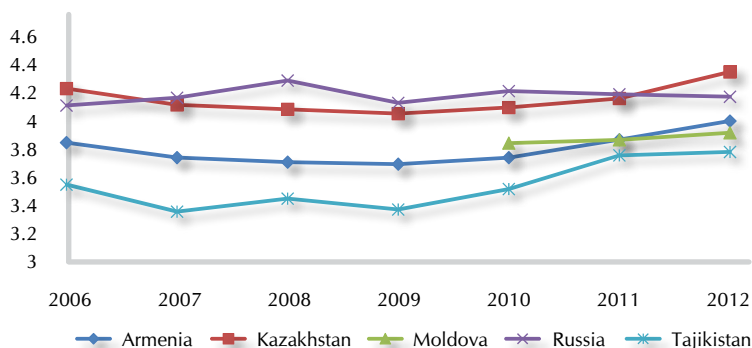


Figure 2.2.
 Global Competitiveness Index

Source: World Economic Forum: <http://www.weforum.org/>, Global Competitiveness Report: <http://www.weforum.org/issues/global-competitiveness/>; authors’ calculations

One of the key indices of a country’s competitiveness is the Doing Business Index, compiled by the International Finance Corporation and the World Bank. Figures 2.3 and 2.4 show the rankings of Armenia, Moldova and Tajikistan and some other FSU countries.

¹⁰ This index is not calculated for Moldova. The indices are as of 2010.

Figure 2.3 demonstrates that the global integration of Armenia and Moldova has made their international trade more open than that of the CU countries, as evidenced by the relevant Doing Business rankings for the ease of trading across borders¹¹. The duties on the majority of products in the three countries are much lower than the CU Single Customs Tariff (CU SCT) (see Table 2.2). At the same time, despite low duties, cooperation with the CU would be beneficial for Tajikistan as in its case the low ranking for cross-border trading is driven by poor trade infrastructure.

Figure 2.3.
Ease of Doing Business: FSU Countries' Rankings on Trading across Borders

Source: World Bank: <http://data.worldbank.org/>, International Finance Corporation: <http://www1.ifc.org/>, Doing Business Report: <http://www.doingbusiness.org/>; authors' calculations

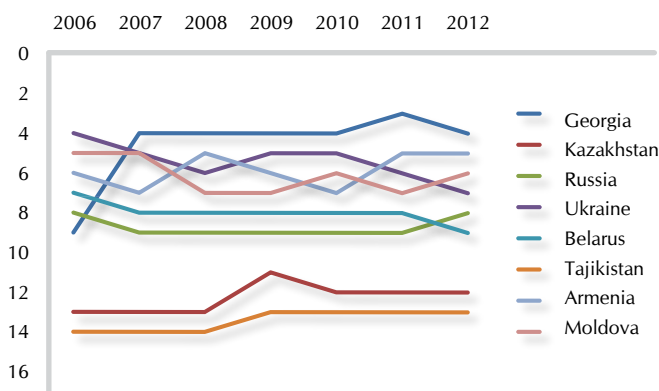


Figure 2.4 shows that only Moldova has a lower level of investor protection than Russia. This indicator also demonstrates that cooperation may not be beneficial between investors from the CU member states and Russia due to these countries' specific business climates. Uzbekistan's attempt to nationalise a subsidiary of MTS is one of the negative examples of investment cooperation¹².

Table 2.2 shows that tariffs in Armenia, Moldova and Tajikistan are higher only for commodities that are primarily imported and have low elasticity of demand (tea, coffee, olive oil, sugar, other agricultural produce). These commodities

¹¹ Doing Business indicators were selected only for 14 countries (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Uzbekistan, Ukraine, and Estonia); therefore, Ranking 1 corresponds to the best indicator among the 14 countries under the review, and not among all countries in the Doing Business report.

¹² In summer 2012, Uzbek authorities seized the property of MTS's subsidiary Uzdunrobity, withdrew its licence and initiated criminal prosecution of the company's managers. According to the official statement, the General Director of Uzdunrobity 'organised a criminal group for uncontrollable profit generation'. The court decision was reversed only after a Moscow apartment belonging to the Uzbek President's elder daughter, Gulnara Karimova, was seized. Karimova was allegedly involved in corrupt dealings with MTS, Vimpelkom and the Swedish company TeliaSonera. More information is available at: <http://www.forbes.ru/news/194397-v-moskve-arestovali-kvartiru-docheri-prezidenta-uzbekistana> <http://www.rbc.ru/rbcfreeneews/20121108211821.shtml>

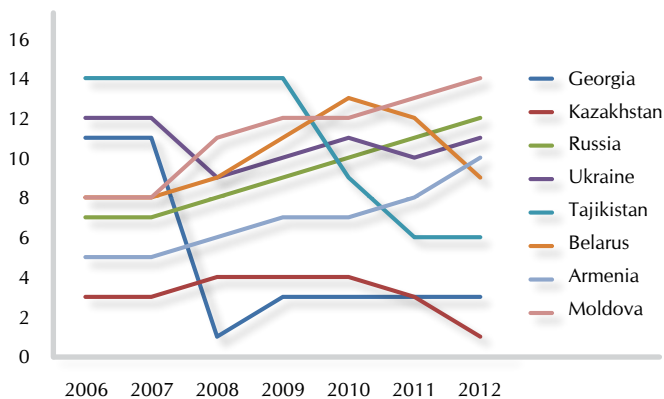


Figure 2.4.
 Ease of Doing
 Business: FSU
 Countries' Rankings
 on Investor
 Protection

Source: World
 Bank: <http://data.worldbank.org/>,
 International Finance
 Corporation:
<http://www1.ifc.org/>, Doing Business
 Report: <http://www.doingbusiness.org/>;
 authors' calculations

Category	Armenia	Moldova	Tajikistan	CU SCT
Animals	14.9	17.5	9.6	24.7
Dairy products	15	14.7	12.5	17.7
Fruits, vegetables, plants	15	14.1	12	11
Tea, coffee	14.2	10.6	6.7	7.7
Cereals	15	13.3	9.9	18.7
Fats, olive oil	13.5	10.7	6.7	8.7
Sugar, confectionary products	14.7	56.3	6.3	13.3
Beverages, tobacco	15	18.2	36	35.2
Cotton	15	0	15	0
Other agricultural produce	14.6	9	6.5	5.8
Fish and fish products	15	4.5	10.3	12.3
Minerals and metals	7.1	3.4	7.8	9.8
Fuels	5	0	5	4.4
Chemicals	0.3	4.5	5.9	6.3
Timber, paper	3.3	6	7.5	12.7
Textiles	9.4	8	10.2	10.7
Clothes	15	12	10.2	13.2
Leather, footwear	13.8	8.6	7.7	7.6
Non-electric machinery	9.3	7.9	5	3.4
Electric machinery	9.9	5.9	5.1	7.3
Transport equipment	9.6	4.3	4.8	10.4
Manufacturing	10.4	5.5	7.7	9.9

Table 2.2.
 Average Tariffs in
 Armenia, Moldova,
 Tajikistan and the
 Customs Union
 Single Customs
 Tariff by Commodity
 Group

Source: World Trade
 Organisation: <http://wto.org/>

carry higher tariffs mainly because they bring higher tax revenues (Coady, Drese, 2002).

Should Armenia, Moldova and Tajikistan integrate into the CU and SES, this does not necessarily mean that the CU tariffs would be lowered. It appears that in the long run the differences between the external tariff rates of these countries and the CU countries would remain. At the same time, Armenia, Moldova and Tajikistan may move towards coordinated macroeconomic policies as the first step towards the integration. As Russia is the dominant country in this group, alignment with the Russian business cycle may add stability, at least, in trade with the FSU countries, by increasing trade volumes. Furthermore, by synchronising with the Russian business cycle, Armenia, Moldova and Tajikistan, as energy importers, may suffer less during periods of especially high prices for energy resources. On the other hand, excessive confidence in the Russian rouble and Russian economic stability in general may result in a considerable drop in production if the Russian economy finds itself in a crisis.

POTENTIAL ROUTES TO INTEGRATIVE COOPERATION OF ARMENIA, MOLDOVA AND TAJIKISTAN WITH THE CU, SES AND EAU

When discussing potential ways for Armenia, Moldova and Tajikistan to cooperate with the CU and SES countries, it is important to remember that, while elaborating new formats for cooperation, any duplication of the formats already in existence should be avoided. Tajikistan has been a party to EurAsEC from 2001, while Armenia and Moldova have EurAsEC observer status (from 2003 and 2002 respectively). In 2011, Armenia and Moldova, like Belarus, Kazakhstan and Russia, signed and ratified the CIS FTA. Tajikistan has signed this agreement but not yet ratified it. Though the agreement is ambiguous, it hardly makes sense for the countries under review to initiate negotiations on any new FTA with CU and SES members. However, it does probably makes sense for all parties to improve the performance of the existing CIS FTA by limiting exceptions and adding new important areas of cooperation to the agreement.

We should emphasise that Eurasian integration has even higher aspirations: from the CU to the SES, on to a planned Eurasian Economic Union that, similarly to the SES, would be open for other countries to join, and further on to a wider Eurasian Union¹³. These processes will not necessarily be limited to the CIS region only (i.e. Northern and Central Eurasia). The global competitiveness and potential of the region could be tapped through its active cooperation in the

¹³ In November 2011, the Declaration on Eurasian Economic Integration was signed, envisaging that a transition to a Common Economic Area based on the WTO standards and principles would commence on January 1, 2012, with the ultimate objective of establishing the Eurasian Economic Union by 2015. At present, a new agreement – the Agreement on the Eurasian Economic Union – is being drafted. The Declaration on Eurasian Economic Integration is available at: <http://www.evrases.com/i/data/item7568-2.pdf>

trade, economic, political and social spheres with other regions of the Eurasian supercontinent: Europe, Eastern, Western and Southern Asia (Vinokurov, Libman, 2012b; Vinokurov, 2013), on a mutually beneficial basis. Therefore, the future of Eurasian integration should be considered as a continent-wide issue.

If some partner states are not ready to join the CU, SES or future EAU but demonstrate an interest in economic cooperation and partnership with these alliances while maintaining their independence to the extent possible, then the CU and SES may offer them the following areas of cooperation for consideration in the relevant agreements and programmes: investments, implementation of joint infrastructural projects; energy and cross-border cooperation; support to SMEs; industrial cooperation; labour migration; agriculture; visa-free regimes; educational exchange programmes, and more. The harmonisation of standards, technical regulations and certification rules could also be considered. If cooperation on these issues reaches beyond the FSU region, it would promote the development of open continental regionalism that would help this region to become the leading link in Eurasia while benefiting greatly from the process (Vinokurov, 2013).

Returning to the issues of Armenian, Moldovan and Tajik cooperation with the CU and SES, we note that deep integration of these countries into the SES would have positive effects in many areas and be very beneficial for the civilised development of a unified labour market. This could be achieved through these countries' accession to the relevant SES agreements¹⁴. A large and diversified SES labour market may absorb additional workforce and provide for higher levels of income and social protection.

Local governments could set up mutually beneficial schemes where they provide investors from the CU and SES countries with easier access and support. Given that national budgets are chronically deficit-ridden, direct foreign investment inflows, with their accompanying positive effects on salary levels, unemployment levels and tax collection would improve the wellbeing of the local population. In addition, in the case of Armenia, the consolidation of export sectors would have a positive effect on competitiveness due to economies of scale.

Thus, Armenia's integration into the CU would make a difference for the national metal and mineral markets through increased investment inflows into the relevant sectors and mutual access to other markets. Should relations between Russia and Georgia improve, the commodities of Armenia may enter the CU area, and particularly Russia, even without a common border with Armenia. The

¹⁴ The Agreement on the Legal Status of Migrant Workers and Members of Their Families (dated December 1, 2010) and the Agreement on Cooperation in Countering Illegal Labour Migration from Third Countries (dated December 1, 2010). See the official website of the Ministry of Economic Development of the Russian Federation: <http://www.economy.gov.ru/minec/activity/sections/formuep/empmove/>

same applies to the Russian textile industry's access to Tajik cotton, although in view of strained relations between Tajikistan and Uzbekistan such cooperation may be risky.

Another promising area could be to improve access to government procurement markets in Armenia, Moldova and Tajikistan. International competitive bidding may help local governments receive better bids, while the CU and SES member states would gain access to additional markets. In addition to the areas of cooperation that are similar to those in the CU and SES, we should note the potentially high value of granting the CU-SES and future EAU access to industries requiring upgrading, since the CU-SES countries' advanced industries, agriculture and service markets could foster the adoption of new technologies and the upgrading of industrial and agricultural equipment.

The results of competitiveness evaluation for Armenian, Moldovan and Tajik economies regarding the CU show that Armenia has a slight comparative advantage over the CU in agriculture, although it has a comparative disadvantage in the mineral production, chemical and woodworking industries. Moldova, in turn, has the comparative advantage in agriculture and other sectors. The low competitiveness of goods from Armenia and Moldova is mainly determined by the similarity of their export patterns to those of the CU member states.

Armenia, Moldova and Tajikistan have certain resources for increasing their exports of minerals (copper, molybdenum and gold in Armenia) and agricultural products (wine and cotton in Moldova and Tajikistan); however, these resources are not extensive enough to drive economic growth.

Out of the three countries under review, Moldova's macroeconomic indicators are closest to those of the Russian Federation.

As evidenced by their different competitiveness indicators, Armenia, Tajikistan and Moldova are at a disadvantage compared to the CU and SES countries, proving that domestic producers cannot always successfully compete with firms from the CU. At the same time, only Moldova has a lower level of investor protection than Russia.

It appears that in the long run the differences in the external tariff rates of these countries and the CU countries will remain. At the same time, Armenia, Moldova and Tajikistan may move towards coordinated macroeconomic policies as the first step towards economic integration.

Therefore, we may conclude that the cooperation of Armenia, Moldova and Tajikistan with the CU and SES member states cannot be exactly classified with any of the models of cooperation between the EU and other countries outlined above, although there are some common features. Consequently, for these countries, individual forms of cooperation with the CU and SES states should be considered.

EURASIAN PARTNERSHIP PROGRAMME FOR THE EURASIAN ECONOMIC UNION

The SES and future Eurasian Economic Union may devise a programme for multilateral cooperation under the working title ‘Eurasian Partnership’ (Pereboyev, 2012) intended to develop different forms of deep integration with the neighbouring countries. It is assumed that the Eurasian Partnership may provide for both bilateral and multilateral cooperation. The focus, however, should be on bilateral agreements that would take into consideration the specificity of each partner. The cooperation could be structured through treaties and joint action plans (as is the case in the European Neighbourhood Policy and EU Eastern Partnership Programme) as well as participation in joint programmes.

The proposed Eurasian Partnership Programme could foster the development of trade and economic cooperation among the countries in the CIS region, and in the future, other strategic partners, without mandatory accession to the CU, SES and EAU. Here a format similar to the EU-Mediterranean Partnership could be used, i.e. the SES may cooperate with any country of the CIS region either moving towards full SES membership or taking the path of shortest distance in the integration. Logically, only the Eurasian Economic Commission could be the initiator and arbiter of such a programme, as any mechanisms of flexible integrative cooperation between the CIS-SES and potential EAU and partner states, both within and outside the CIS region, would require the implementation of the relevant regulations in the legal framework of these alliances, including the international treaty on the establishment of the Eurasian Economic Union.

To summarise, when devising forms of trade and economic cooperation and integrative interaction of the Customs Union, Single Economic Space and future Eurasian Economic Union with partner states, such as Armenia, Moldova and Tajikistan reviewed in this study, consideration should be given to the ways in which similar alliances cooperate with other countries. World practice shows that different formats of cooperation can be considered: these may imply a move towards complete integration ensuring the shortest “distance” between countries, while retaining a policy of independence towards third countries.

As Eurasian integration could in future reach beyond the FSU region, the EES and future EAU need a range of instruments to allow flexible integrative cooperation with partner states that may be interested in deep trade and economic cooperation and in movement towards accession. The SES and EAU Eurasian Partnership Programme proposed here could serve as the fundamental basis for trade and economic cooperation, and even the integration of countries with the SES and future EAU, with due consideration of the interests and specifics of all

parties. The instruments reviewed in this report could be applied to develop closer, mutually beneficial relationships with other countries under the Eurasian Partnership. The criterion for acceptance of a project, in the context of EES and EAU interests, would be expected economic gain related to the expansion of access to commodity markets, investment opportunities, unification of technical regulation, free movement of capital, utilisation of stock market capacity and using the Russian rouble as a reserve currency.

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APPENDIX

Moldova's Revealed Comparative Advantage Indices per Commodity Group

Index	Agriculture	Minerals and chemical production	Articles of leather and wood	Textiles	Articles of stone and iron	Manufactured goods	Other
1	12.84	0.24	0.92	23.17	0.38	3.59	8.43
2	0.02	0	0	0.04	0	0.01	0.01
3	0.76	-0.54	-0.26	0.91	-0.23	0.06	0.76
4	1.82	-0.98	-0.66	3.25	-0.6	0	1.82

Source: UN
Comtrade 2011:
[http://comtrade.
un.org/](http://comtrade.un.org/); authors'
calculations

Armenia's Revealed Comparative Advantage Indices per Commodity Group

Index	Agriculture	Minerals and chemical production	Articles of leather and wood	Textiles	Articles of stone and iron	Manufactured goods	Other
1	19.5	0.03	0.03	2.13	1.18	19.5	0.03
2	0.01	0	0	0	0	0.01	0
3	-0.13	-0.97	-0.97	-0.74	-0.65	-0.13	-0.97
4	1.14	-3.3	-2.96	-0.86	-0.13	1.14	-3.3

Source: UN
Comtrade 2011:
[http://comtrade.
un.org/](http://comtrade.un.org/); authors'
calculations

Tajikistan's Revealed Comparative Advantage Indices per Commodity Group

Index	Agriculture	Minerals and chemical production	Articles of leather and wood	Textiles	Articles of stone and iron	Manufactured goods	Other
1	124.2	0.72	0	10.1	0.22	124.2	0.72
2	0.07	0.00	0	0.01	0	0.07	0
3	-0.26	-0.97	-1	0.89	-1	-0.95	-0.8
4	0.88	-2.88	-6.38	4.23	-4.58	-2.28	-0.8

Source: UN
Comtrade 2011:
[http://comtrade.
un.org/](http://comtrade.un.org/); authors'
calculations

Category	Code Numbers	Groups in the category
Agriculture	01-24	Live animals, foodstuffs, oil and fats, drinks, tobacco, etc.
Minerals and chemical production	25-41	Mineral and chemical production, plastics
Articles of leather and wood	42-50	Articles of leather and wood
Textiles	50-67	Textile products, silk, cotton, etc.
Articles of stone and iron	68-84	Minerals, iron, and articles thereof
Manufactured goods	85-93	Mechanical and transportation equipment
Other	94-97	Works of art, etc.

**Distribution of
Commodity Groups**

Source: Harmonised System Codes, World Customs Organisation: <http://www.foreign-trade.com/reference/hscod.htm>

Denomination	Chemicals	Mechanical equipment	Non-electronic industry	Electronics	Transport equipment	Fabrics	Minerals
Product Diversification Index	114	120	138	67	72	132	65
Market Diversification Index	68	116	136	102	95	49	94
Competitiveness Effect Index	134	18	118	94	8	146	129
Geographic Specialisation Index Effect	68	93	69	41	44	73	141
Export Products Specialisation Index	131	94	10	29	12	145	1
Adaptation Effect Index	51	136	116	109	137	30	164

Armenian Ranking of Trade Performance Index Elements

Source: International Trade Centre: <http://www.trademap.org>

Denomination	Fresh produce	Processed products	Wood	Textiles	Chemicals	Mechanical equipment	Non-electronic industry
Product Diversification Index	103	159	105	104	146	147	132
Market Diversification Index	159	162	74	130	88	147	118
Competitiveness Effect Index	80	12	124	44	122	88	136
Geographic Specialisation Index Effect	67	113	67	31	119	107	4
Export Products Specialisation Index	155	104	26	114	24	15	131
Adaptation Effect Index	46	155	103	83	88	11	78

Tajik Ranking of Trade Performance Index Elements

Source: International Trade Centre: <http://www.trademap.org>

3

Tajikistan and the Customs Union: Challenges and Opportunities

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Disintegration processes took place after the collapse of the Soviet Union. In the second half of the 2000s they were replaced by a desire to unite in new integration structures such as the Commonwealth of Independent States (CIS) and Eurasian Economic Community (EurAsEC). During 2008-2010, after a decision by the heads of EurAsEC a Customs Union (CU) of Belarus, Kazakhstan and Russia was formed. In 2012, the first agreements within the framework of the Single Economic Space (SES) came into force. SES is designed to ensure: harmonisation of legislation in all areas of cooperation between the countries; and freedom of movement of goods, services, labour and capital. Other member states of EurAsEC will join the Customs Union and Single Economic Space as soon as their economies are ready.

This article presents conclusions on the eventual economic impact on the economy of the Republic of Tajikistan as a result of accession to the Customs Union and SES. The conclusions were obtained in a study conducted by the EDB Centre for Integration Studies.

The economy of Tajikistan is agro-industrial, based on agriculture (cotton, crops growing, cattle breeding) and industry (mechanical engineering, production of aluminium, fertilizers, textile and light industry, energy and consumer goods). Relative remoteness, communication isolation from the existing global transport infrastructure, mountainous terrain, and lack of access to the sea determines the unfavourable economic and geographical situation of the country. Nominal GDP per capita in Tajikistan in 2011 was \$836 (IMF data). Estimate for 2012 is \$912.

Since 1998, real GDP has grown in Tajikistan. In 2011, the rate of growth of GDP and GDP per capita amounted to 7.4% and 5.9%, respectively, which is higher than the average values for EurAsEC. The basis for economic growth in Tajikistan is export of goods (primarily aluminium and cotton) and growing domestic demand (primarily in the form of private consumption). Private consumption is predetermined by remittances from labour migrants from abroad, mainly from Russia. A significant share of private consumption uses imported goods, including food. Remittances stimulate the consumer market, construction and manufacturing services.

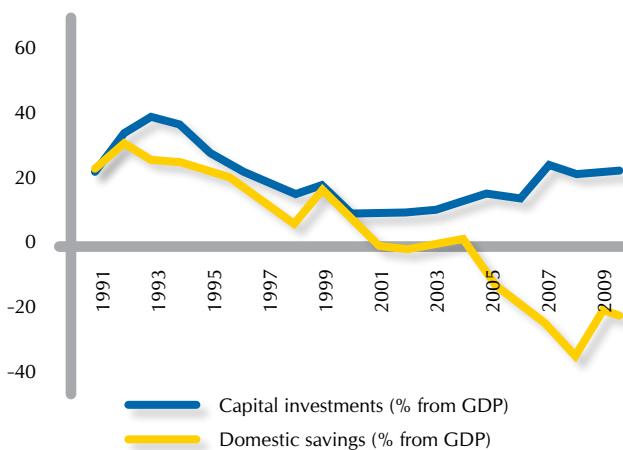
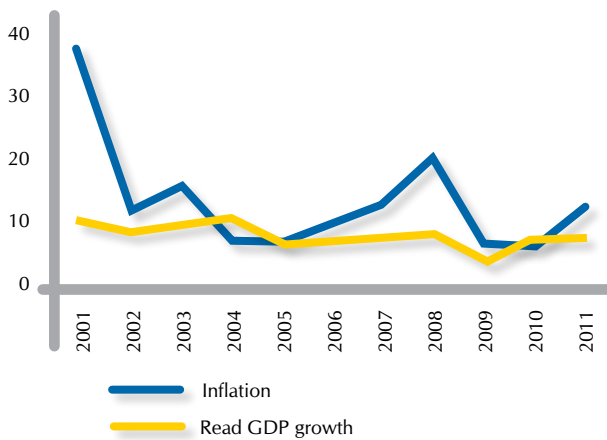


Figure 3.1.
Dynamics of
inflation, real GDP
growth, capital
investment and
domestic savings
of the Republic of
Tajikistan

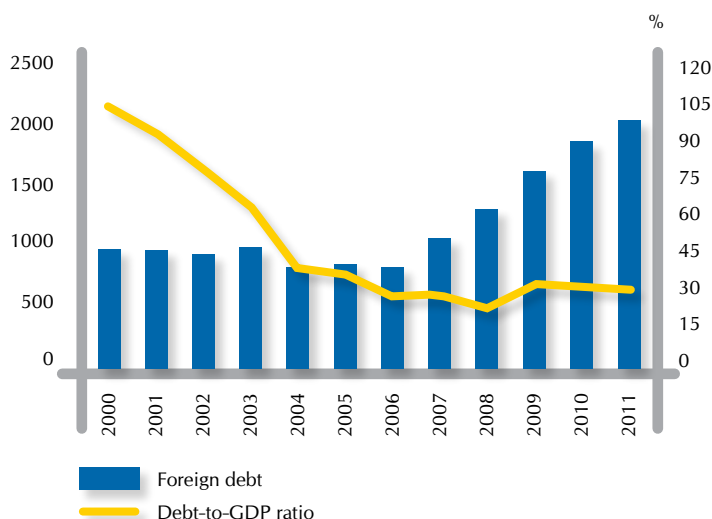
Source: WB, IMF

Tajikistan's dependence on external factors is associated not only with export earnings, but also with high foreign debt, only 13.4% of which was covered in 2010 by gold and foreign exchange reserves of Tajikistan. The index of foreign debt is the lowest among the countries of the EurAsEC.

The ratio of external debt to GDP of Tajikistan has been declining since 2000, and only slightly increased in 2009-2010. The increase was related to the loan provided by the EurAsEC Anti-Crisis Fund (ACF). In 2010, Tajikistan fully complied with its obligations to the Export Credit Bank of Turkey. Most of the external debt is concessional multilateral loans from the World Bank (WB), the Asian Development Bank (ADB) and the International Monetary Fund (IMF). The largest bilateral creditors are PRC and Kuwait Fund.

Figure 3.2.
Tajikistan foreign
debt dynamics
(\$ million)

Source: Ministry
of Finance of the
Republic of Tajikistan



DEVELOPMENT PROSPECTS

According to a World Bank report (WB, 2011), to maintain steady growth Tajikistan should integrate into the world economy, just as several developing countries did in the last decade. One of the ways for Tajikistan to integrate is accession to the Customs Union. As Tajikistan is already a member of the EurAsEC, joining the CU can open additional opportunities for it to integrate into the world economy (Shadikhodjaev, 2008, 2009).

The increase in private investment and exports of agricultural products, as well as diversification in agro-processing and light industries, are possible if private investors from Tajikistan regions will be able to get access to neighbouring markets with a sufficiently favourable investment climate.

S. Coulibaly (Coulibaly, 2012) identifies the main factors for the support of economy growth of Tajikistan, including:

- Increasing the contribution of remittances;
- Rise of agricultural production;
- Changes in trade and trade partners' structure.

Russia ranks first in the share of exports in Tajikistan. As Tajikistan is a landlocked country, its priorities are focused on trade with traditional Soviet partners and regional powers such as the EU and China. This geographical dimension should be kept in mind when developing export growth strategy for Tajikistan. The author notes that Tajikistan could benefit from export-oriented growth strategy.

DEVELOPMENT CHALLENGES

In 2010 the Tajik government set a target to double GDP in 10 years – Tajikistan has a high growth potential of 7% per year. Rising prices for cotton and aluminium (Tajikistan's main export products – 17% and 63% in 2007, respectively) and the growing demand for the Tajik workforce (especially in Russia) were one of the factors of the successful growth in the 2000s. Inflows from remittances (46% of GDP in 2008) contributed to the growth of domestic demand for goods and services, particularly for food and agricultural products. However, private investment accounts for only 5% of GDP – the lowest value among European and Asian countries. The banking sector remains weak due to the debt of the cotton sector and problems with state-owned enterprises, and the overall financial situation remains unstable.

The report of the World Bank (WB, 2011) and the work of Suleiman Coulibaly (Coulibaly, 2012) state that Tajikistan products are uncompetitive in the markets of neighbouring countries due to: poor infrastructure; the high cost of goods transportation within the country and abroad; and the complexity of bureaucratic procedures at the border. To improve transport links with its neighbours, Tajikistan needs to coordinate efforts with the surrounding countries.

Also, S. Coulibaly (Coulibaly, 2012) notes that Tajikistan can continue to enjoy higher growth rates due to strong domestic consumption only as long as the flow of remittances is stable. But the experience of developing countries, which have grown steadily over the decades, shows that increasing investment and expanding exports are the necessary elements to enable global demand.

In 2009 the Business Environment and Enterprise Performance Survey (BEEPS) was conducted by the World Bank in a number of countries, including Tajikistan. It highlighted the following obstacles to business and private investment:

- Unattractive investment climate;
- Taxes;
- Power outages;
- Corruption elements;
- Customs regulations;
- Trade regulations.

Investment in health and education services is also crucial for long-term growth and development. The social security system in Tajikistan is ineffective in terms of reducing poverty and vulnerability (WB, 2011).

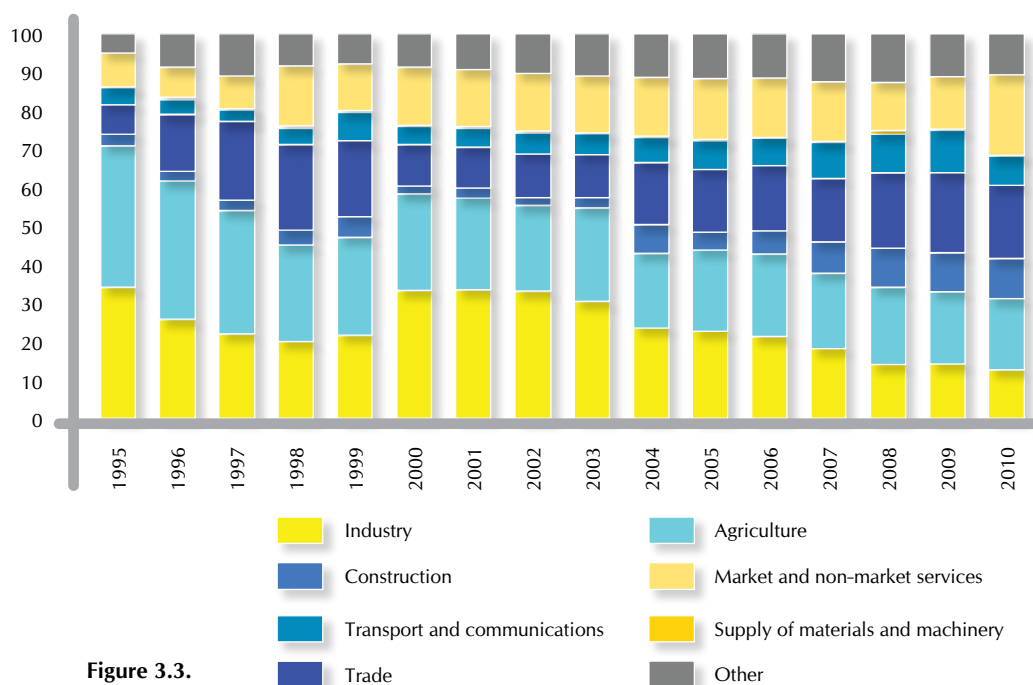


Figure 3.3.
GDP structure by
sectors (%)

SECTORAL STRUCTURE AND COMPARATIVE ADVANTAGES OF TAJIKISTAN

Despite the increasing role of other sectors, industry and agriculture remain the basis of the economy of Tajikistan. A major part of the population is occupied

in these sectors; their products provide income from foreign trade and inflow of foreign exchange.

The basis of agriculture, which employs 66% of the population, is crop growing (cotton and grain crops). The share of crop production was 98.5% (RT, 2012) of agricultural production in 2010, and 75.9% in 1995. Crop production includes raw cotton (one of the main exports), grain, corn, fruit, rice and potatoes. Animal breeding products include meat, milk, eggs, and wool.

The industrial production structure (see Figure 3.4) is dominated by non-ferrous metals (36%) and food industry (27%). Tajikistan's export goods include: aluminium, food products, beverages, cotton fabrics and garments.

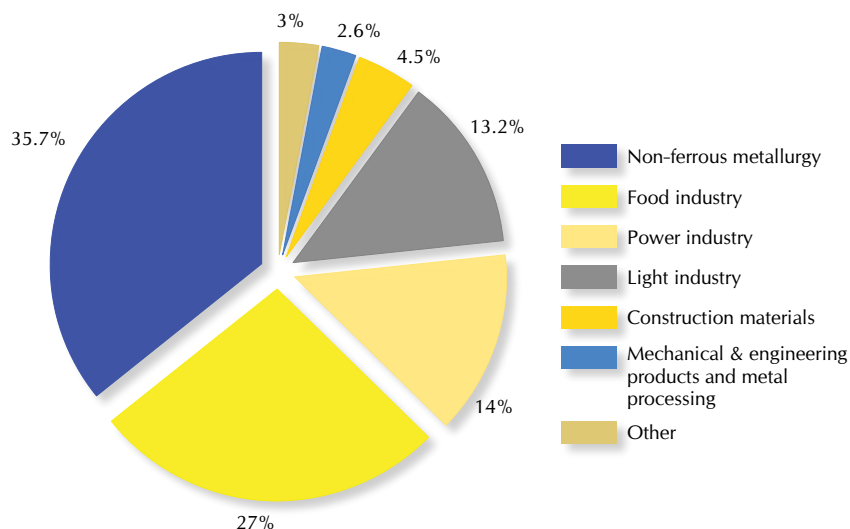


Figure 3.4.
Industrial output
structure in 2010

Source: Agency for
Statistics under the
President of the
Republic of Tajikistan

At the moment, the backbone and the most competitive sectors of Tajikistan's economy are aluminium and cotton fibre production. They provide a substantial share of the country's export earnings.

One of the most important comparative advantages of Tajikistan is hydropower. The potential hydropower is much higher than domestic demand. It can be sold to neighbouring large, energy-scarce economies, in particular, the countries of South Asia and China.

Tajikistan also has substantial reserves of coal that can be used as a fuel for the production of gas thermal energy. This would be the most cost-effective way to reduce the seasonal imbalance in the energy supply, as hydropower production is concentrated in the summer months.

In agriculture, cotton is likely to remain an important export item, despite the recent decline in acreage and exports. Moving up the value chain in cotton export – from fibre export to cotton fabrics represents a potential for diversification of exports.

Gardening and related products may also have export potential. The main export markets for these products are likely to be neighbouring countries, Russia, and China, which is fast becoming an important export market for Tajik goods.

In addition, Tajikistan can develop its livestock sector. So far the prospects of these potential agricultural export sectors have not been realised due to excessive regulation and sometimes unpredictable intervention by local authorities.

Tajikistan has a comparative advantage in the export of labour services, since the working-age skilled Tajik workers meet the demand for labour in Russia.

ESTIMATING THE TRADE POTENTIAL OF TAJIKISTAN

Analysis of the trade potential of Tajikistan is based on the approach proposed in a number of articles by Ricardo Hausmann and Bailey Klinger (Hausmann, Klinger, 2006, 2007). Hausmann and Klinger found a link between the current export structure of the country and its subsequent pace of development. As a measure of exports structure, they suggested using the parameter “complexity” of export basket. The level of “complexity” depends on how developed are the countries exporting in average goods comprising the export basket of the country under review. Also, analysing the dynamic features of occurrence of new product groups in the country’s export baskets, Hausmann and Klinger proposed a methodology for constructing the potential evolution of the current country’s export basket, based on the fact that the change of revealed comparative advantages of the country is largely determined by the level of “closeness” of the goods to the current structure of its exports.

The main argument in favour of using this methodology is the fact that the classical measures of similarity between the goods, such as the production intensity factors (Leamer, 1984) or technological complexity (Lall, 2000) only partially explain the observed pattern of changes in the structure of exports.

Analysis of the structure and productivity (“complexity”) of the export basket of Tajikistan has been performed. The results of the analysis show that, despite the relatively low level of “complexity” of the current export basket of the country, there are opportunities to increase the productivity of its exports. This has a positive effect on the economic growth prospects of Tajikistan, as the relationship between productivity of exports and medium-term economic growth rates is demonstrated in the economic literature.

PRODUCTS WITH THE GREATEST EXPORT POTENTIAL

In this model, products with the greatest export potential refer to products that are most closely located to the current export basket of the country. Fifteen items are represented in the table below that are the most likely potential export goods for Tajikistan, and for which the level of "complexity" is above the level of productivity of the current export basket of Tajikistan. That is, these are the products whose appearance as a Tajik export will make the export structure of the economy more advanced. Also, the table shows the spheres of production, corresponding to those goods.

It should be noted that this list does not fully capture all the product categories that have high potential to improve the country's export basket – highly productive goods. This list shows just some of the areas in which the country has the most potential.

HS code of the product group	Product group
8418	Refrigerators, freezers and other refrigerating or freezing equipment
7604	Aluminium bars, rods and profiles
6908*	Ceramic glazed paving, cladding tiles for floors, ovens, fireplaces or walls
6810	Cement, concrete or artificial stone goods
6102*	Women's coats, duffle coats, capes, cloaks, jackets (including ski-jackets), windbreakers
4418	Wood products, joinery and carpentry
3917*	Tubes, pipes and hoses, and fittings
2709*	Crude oil and crude petroleum products
2106	Other food products
1602	Other ready-made or preserved meat, meat offal or blood products
402*	Milk and cream, concentrated or containing added sugar
401*	Milk and cream, not concentrated nor containing added sugar

Table 3.1.
Most high-yield
products for
Tajikistan export

Source: CEFIR
calculations

Analysis of the Tajik trade capacity, based on the method of Hausmann, revealed a relatively low level of technological "complexity" of the country's export basket. However, there are opportunities to increase the productivity of its exports. The possibility of efficient production and export of new products are determined by the pool of institutional, technological and human resources available to Tajikistan.

In the natural course of development of the export basket, the growth of exports will lead to an increase in exports of low-and medium-technology intensive goods; and the increased benefits of foreign trade will be relatively small. A

more significant increase in the efficiency of the export basket may require significant efforts aimed at the organisation of the effective production of products that are a brand new innovation for Tajikistan. A characteristic feature of the export basket of Tajikistan is its large focus on CU countries. This focus broadly limits the potential for increasing benefits of foreign trade, in particular, complicates the inclusion into the export basket of new goods for Tajikistan, oriented towards export to non-EU countries.

NON-TARIFF BARRIERS

Analysis of tariff and non-tariff protection measures in force in Tajikistan and the CU has revealed that the Single Customs Tariff of the CU is significantly less homogeneous than the customs tariff of Tajikistan. Reduction of homogeneity of customs tariff of Tajikistan in accession to the CU can adversely affect administration of the foreign trade. On the part of the CU special measures for assistance to Tajikistan shall be taken in the field of customs control.

Simple average of ad valorem parts of import duty rates of Tajikistan's tariff schedule is 8.71%, slightly below that of the Single Customs Tariff of the CU, which amounts to 9.45% at the end of 2013. Joining the CU should not lead to significant diversion of trade of Tajikistan in favour of the CU members.

Table 3.2.

Average and weighted average tariff of the Customs Union and the Republic of Tajikistan (change in time with account to WTO obligations, %)

	Customs Union		Tajikistan	
	Simple average tariff	Weighted average tariff	Simple average tariff	Weighted average tariff
August 2012	10.1	8.13	8.58	6.43
December 2013	9.45	7.55	8.71	6.41
December 2020	7.9	6.19	7.73	5.7

Source: Calculations of authors

Priorities of industry protection for Tajikistan and the CU are similar. Harmonisation of import duties for priority sectors should not bring significant changes to Tajikistan.

Non-tariff regulation of foreign trade of Tajikistan is largely aimed at monitoring compliance with the technical and sanitary measures generally to meet the international standards. In contrast to the CU, Tajikistan does not apply any special measures envisaged by law – anti-dumping duties and investigations, protective measures, quotas for import and export of goods. Sectors involved in international trade enjoy measures of government support that do not relate to non-tariff regulation measures.

ECONOMIC EFFECT OF TAJIKISTAN'S ENTRY INTO THE CU AND SES

According to estimates in the economic literature, the contribution of changes in total factor productivity to the economic growth in Tajikistan in the 2000s was 56%, contribution of capital accumulation – 36%, and contribution of growth of labour force – 8%. Using factor contribution assessments proposed in the literature, we can give a rough estimate of the impact on economic growth of the accession of Tajikistan to the CU and SES. Impact on economic growth occurs primarily through increased investment and capital, and growth of total factor productivity. Labour resources are not a limiting factor for economic growth, as Tajikistan is a labour surplus region. Staff development within the framework of this approach is an integral part of the productivity growth.

Static one-time effects of a commercial nature in joining the CU will be small in general. Assessment of one-off effects for the most significant sectors of Tajikistan: mining: 0.8–0.9%, food industry: 0.8–1.15%, agriculture: 0.4–0.5%, electricity: 0.7–0.84%, and service sector: 0.5–0.6%.

At the same time, evaluations of the dynamic (long-term) effects shown below are significantly higher both in absolute terms and in terms of time length.

The share of investment in GDP of Tajikistan remains low (12% on average in the first half of the 2000s to slightly above 20% in the early 2010s) and significantly lower than not only the Baltic States, Central and Eastern Europe, but the CU-SES countries, which means the huge potential of investment in capital as a source of future economic growth.

Accession to the CU-SES is accompanied by agreements on harmonisation of legislation in the field of trade, and a number of agreements on additional investments. Besides, the creation of a single economic space, affecting the markets for goods, capital and labour within the CU, creates additional incentives for investment in the CU countries not only from member states, but also from outside the CU. Accession of Tajikistan to the Customs Union provides additional opportunities to attract foreign investment.

It should be noted that increase in investment after accession to the CU is no axiom. There are examples of how poor investment climate did not allow the use of the window of opportunity provided by economic integration in the framework of the economic union.

At the same time, subject to most favoured nation treatment, the volume of investments, both public and private, from the CU and from the outside, can reach significant values.

If the growth rate of capital will be able to reach the level of capital accumulation, (for example, in the Baltic countries in the 2000s 7.9% per annum against the existing 5.4%), this would generate an additional source of GDP growth, while

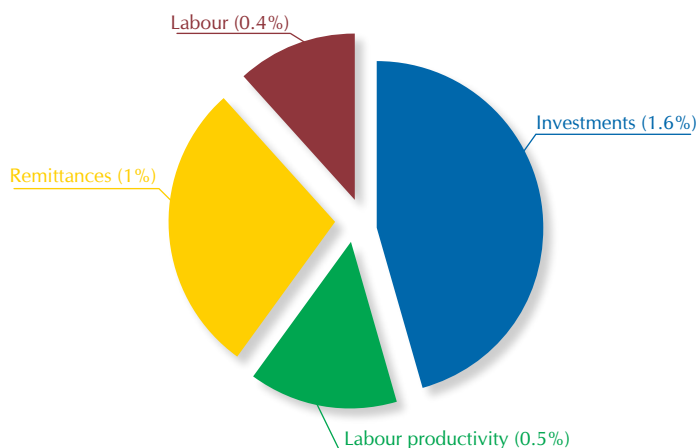


Figure 3.5.
Additional GDP
growth potential
from the accession
of Tajikistan to the
CU-SES

maintaining the growth parameters of the 2000s that gave an additional 1.6% GDP growth per year.

Attraction of foreign direct investment could affect the change in aggregate productivity in the economy through the transfer of technology and increased competition. According to estimates based on Russian data, for those businesses that are located close to the production possibility frontier, increasing the share of FDI in total sector sales by 0.1% will increase overall productivity of firms by 1%. As noted above, the growth of total factor productivity by 1% leads to economic growth of 0.5%.

The investment potential of remittances, capable, as discussed below, to provide additional investments in the amount of 5% of GDP and 1.5% of capital gains, could potentially add another 1% of GDP per year.

Attracting investment will require the creation of new jobs. Involvement of the new labour force in production will allow increasing GDP growth by 0.3–0.4% per year and will partly solve the problem of unemployment.

NUMERICAL ANALYSIS OF THE CONSEQUENCES OF ACCESSION OF TAJIKISTAN TO THE CU USING GLOBE MODEL

GLOBE model is a computational model of general equilibrium, relying on GTAP database (Global Trade Analysis Project, coordinated by the Centre for Analysis of World Trade in the Department of Agricultural Economics, Purdue University, the city of West Lafayette, Indiana, USA). At the moment, the database is the most comprehensive collection of data on the economy of various countries and world trade.

GTAP database in its recent 8th version, covers 57 economy sectors and 129 regions of the world (each such region is either a country, if it is a sufficiently large player in the global trade, or an association of a few small countries: data on Tajikistan are contained in this database not as for an independent state, but as a part of an aggregated Rest of Former Soviet Union (XSU) region, which includes Turkmenistan and Uzbekistan in addition to Tajikistan). It contains data on trade flows between regions, the economy of countries (social accounting matrices, data on taxes, duties, subsidies, tariffs, etc.).

GLOBE model belongs to a class of computable general equilibrium (CGE) models. The distinctive feature of these models is that all (in some approximation) sectors of the economy are described within them: households, manufacturing sector, state, as well as the rest of the world.

The tables show that in both cases the accession of the XSU region to the Customs Union also has a beneficial effect on it: all macro indicators are increasing. With that, changes of some key indicators (GDP, output, exports) for simple average tariff are higher than for weighted average tariff, while for the other parameters the positive changes are a little lower than for weighted average tariff. For other countries of the Customs Union change of macroeconomic indicators is either positive or slightly negative. This reduction of macroeconomic indicators is small and in practice is unlikely to be noticeable.

Main indicators	Russia	Belarus	Kazakhstan	Ukraine	XSU
Household consumption	-0.0029	-0.0834	-0.0778	0.0093	0.6679
Public spending	-0.0545	-0.1014	-0.1982	0.0223	0.452
Total investments	0.0706	0.0215	-0.0332	0.02	0.6999
Aggregate domestic demand	0.0051	-0.0509	-0.0777	0.0149	0.6402
Demand for imports	0.3412	0.1603	0.2636	-0.0321	1.1634
Export	0.6353	0.226	0.3971	-0.1024	0.4031
GDP (calculated based on expenditures)	0.0974	-0.053	-0.003	-0.0097	0.266
Production volume	0.1384	0.01	0.0289	-0.0366	0.5199
Use of intermediate goods	0.1769	0.0365	0.0509	-0.053	0.6674

Table 3.3.
The change of basic macroeconomic indicators in the key countries after accession of XSU region to the CU without changing factor productivity (% , weighted average tariff)

Source: CEFIR Calculations

Numerical analysis of static effects of consequences of accession of Tajikistan to the CU using GLOBE model showed that accession of Tajikistan to the CU would lead to a slight change in the basic macroeconomic indicators in Tajikistan. Of the changes, the following should be noted:

Table 3.4.
The change of basic
macroeconomic
indicators in the
key countries after
accession of XSU
region to the CU
without changing
factor productivity
(%, simple average
tariff)

Main indicators	Russia	Belarus	Kazakhstan	Ukraine	XSU
Household consumption	-0.0177	-0.0846	-0.1002	0.0342	0.5874
Public spending	-0.0696	-0.0975	-0.2065	0.0346	0.3284
Total investments	0.0796	0.0305	-0.0147	0.0368	0.6641
Aggregate domestic demand	-0.0036	-0.0476	-0.0843	0.0351	0.5629
Demand for imports	0.3558	0.1687	0.2828	-0.0028	1.26
Export	0.6559	0.2293	0.4308	-0.0785	0.6522
GDP, calculated based on expenditures	0.0897	-0.0548	-0.0031	0.0058	0.3416
Production volume	0.1329	0.0023	0.028	-0.0105	0.5903
Use of intermediate goods	0.175	0.0265	0.0493	-0.0204	0.734

Source: CE FIR
Calculations

- Increased production in a number of sectors, including those where production is an essential export item (for example, in metallurgy and agriculture, which are very important for Tajikistan), which may contribute to reducing unemployment;
- Growth in total imports almost in all sectors;
- Increase of investments and government spending;
- Increase in real personal income of Tajikistan.

LABOUR RESOURCES

One of the main benefits to Tajikistan from accession to SES is joining a single labour market. SES agreements in the field of labour migration (the Agreement on the Legal Status of Migrant Workers and Members of their Families; and the Agreement on Cooperation on Combating Illegal Labour Migration from Third Countries) are aimed at uniting labour resources of the participating countries, and the establishment and effective functioning of the common labour market. Agreements define the legal status of migrant workers and their families; regulate labour relations of migrant workers, as well as the main issues related to social security of migrant workers and members of their families. The result of the agreements is to reduce the main barriers for employment of migrant workers.

Removing labour market barriers is likely to result in an increase in the degree of legalisation of employment than to increase of involvement of Tajik citizens in labour migration. According to expert estimates, accession of Tajikistan to the CU will only lead to an insignificant increase in the number of migrant workers.

For part of the migrants, removal of formal requirements would increase the duration of migration periods. Collectively, according to expert estimates, the accession of Tajikistan to the CU will lead to migration volumes increasing by 10-15%.

After accession of Tajikistan to the CU and adoption of the appropriate agreements on labour migration, the salary of migrant workers in some measure will increase to that of Russian citizens. At the same time, it should be noted that an influx of workers into the labour market may cause a decrease in the equilibrium wage. Estimated growth of wages of migrant workers after the accession of Tajikistan to the CU is from 9% to 28%.

Estimates of the growth of remittances after the accession of Tajikistan to the CU are in the range of 15-25%, which means a possible increase in remittances up to \$3.4-3.7 billion and the share of remittances to 49-53% of GDP (assuming GDP growth of 7% per year). It is important to note that all calculations are made based on the assumption of sustaining positive trends of economic conditions in recipient countries (especially Russia).

Growth of migrants wages	Growth of migration volume		
	5%	10%	15%
10%	15%	21%	27%
15%	20%	27%	32%
30%	36%	43%	49%

Table 3.5.
The growth in remittances of migrant workers (forecast)

Source: Calculations of authors

Remittances which are currently used primarily for consumption (which is crucial for maintaining and improving the standard of living and poverty alleviation) represent a huge potential for the growth of savings, and thus for financing private investment. The growth potential of investment financing from private savings already amounts to \$300 million. Accession to the SES, increasing the expected remittances by 15-25%, increases the growth potential up to \$375 million, or about 5% of GDP. How much of this potential will be used to finance investment, depends on the ability of the banking system to provide savings instruments that will forward savings of the population to the banking and financial system, thus allowing to accumulate funds for investment.

Migration plays a key role, especially in poverty reduction, and therefore, in achievement of social security and sustainable development. At the same time, migration of skilled workers leads to an outflow of skilled workforce, and thus to the loss of qualification potential of the country, which may adversely affect the pace of economic growth. A balanced policy requires the use of the benefits of migration (through population income growth from foreign remittances,

gaining skills and qualifications while working abroad) with an active policy of creating new productive jobs in the country, which would allow to retain skilled workers and provide a new basis for sustainable economic growth. Creation of favourable business environment and attracting investments in the national economy will contribute to creation of new innovation jobs and increase competition with jobs abroad.

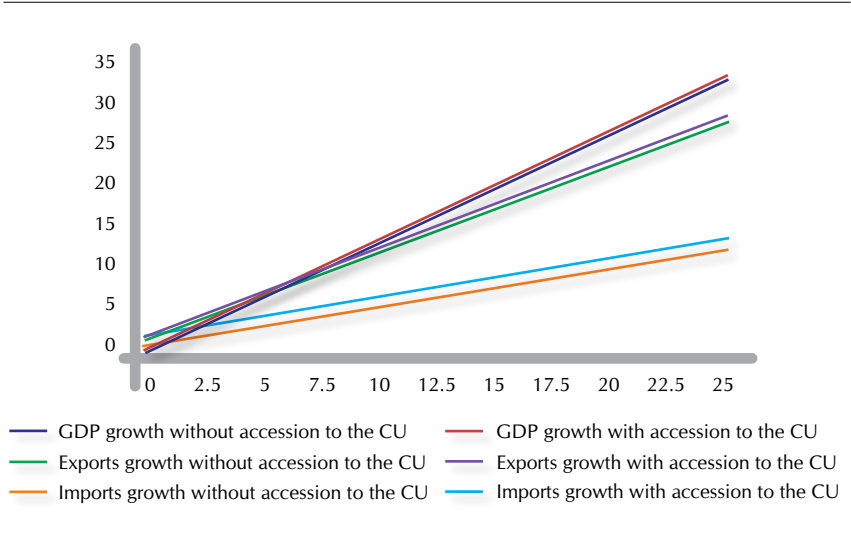
State policy of export of workforce labour should be implemented to support temporary labour migration. To support and protect migrant workers it is crucial to leverage the opportunities offered by the agreements within the SES, and to negotiate extension of the existing agreements towards providing full social insurance, mutual recognition of diplomas, and access to initial vocational training in the host country.

All of the above leads to the conclusion that at the initial stage Tajikistan will get moderate positive effect from accession to the CU.

However, the benefits of joining the CU will increase if Tajikistan will be able to take advantage of the investment opportunities discovered, and to ensure growth the productivity of production factors. Thus, growth of total factor productivity is able to provide the main contribution to GDP growth, increase of exports and imports (i.e., the development of foreign trade).

Figure 3.6.
GDP growth
in percentage
vs. growth in factor
productivity

Source: Calculations
of CEFIR



As for the rest of the countries of the Customs Union, the accession of Tajikistan does not affect significantly their economies. We shall note, however, more favourable investment opportunities for companies engaged in the hydropower, mining and agriculture in Tajikistan.

RECOMMENDATIONS FOR A PACKAGE OF MEASURES IN CASE OF TAJIKISTAN'S ACCESSION TO THE CU AND SES

On the basis of the analysis, a package of measures can be formulated that will contribute to the most efficient trajectory of development of Tajikistan within the framework of CU-SES. The package of measures represents recommendations by blocks in the following areas: foreign trade, investment, support for state budget, and migration.

Assessment of the effects of Tajikistan's accession to the SES showed that static (immediate) trade effects are positive but smaller in absolute value than the possible medium-and long-term effects primarily associated with investment and productivity gains that can provide an extra boost of potential GDP growth by 3.5% in the medium term.

Implementation of only part of the measures will certainly lead to positive results; but their effect will be more short-term and not so significant in absolute terms than if the whole package is implemented. For example, in case of concentration on foreign trade preferences, as shown by calculations, the static (immediate) effect will not be so significant. However, failure to realize investment potential of the agreements and focus the economy to export will result in the opportunities offered by the single market of SES not being used. Concentrating only on agreements on labour migration, without improvement of the investment climate, as well as the potential of the banking system, will lead to "guzzling away" the additional flows of remittances from workers abroad. This will have short-term positive effect on GDP growth and poverty reduction, but will not increase the potential long-term growth in the long term.

Foreign trade – A transitional period will be required to approach the rates of customs tariff of the SES. The introduction of an adaptation period of up to 3 years will be required in order to adapt the economy through budgetary support measures, and to obtain the effects of remittances that will compensate for the slight increase in prices, related to changes in the customs schedules.

On the part of the CU, special assistance measures must be undertaken for Tajikistan in the field of customs supervision and administration, as CU SCT is significantly less homogeneous compared with the customs tariff of Tajikistan. Reduced homogeneity of Tajikistan's customs tariff in accession to the CU may affect negatively the administration of foreign economic activity. The introduction of new and improved customs administration procedures will help suppress the illegal flow of goods and improve the condition of the state budget.

Convergence of practices of non-tariff regulation of foreign trade will be required, as some divergence of non-tariff regulation measures of the CU and Tajikistan is observed in terms of technical barriers to trade.

Investments – The most favourable strategy within the framework of the accession to the CU is export focus. The investment potential of the country is quite high, and analysis of growth factors indicates that investments may give additional 2% of annual growth, subject to improving production efficiency. Presence of a large amount of unused labour resources will contribute to greater efficiency in the use of new capital.

Entry into the SES will largely simplify and make clear the rules of the game to business, which will increase the flow of direct investments from SES residents. From the government, a number of measures aimed at promoting the creation of the necessary market infrastructure (distribution, transport logistics, telecommunications, finance, roads, and warehouses) are required.

Key sectors of the economy for investment are: non-ferrous metals (represented primarily by aluminium production), hydropower, agriculture, food industry, light industry (mainly – textiles). In addition to these sectors, investment resources are necessary for infrastructure development purposes and human capital.

The volume of investment resources that could be easily and completely absorbed by the economy now exceeds \$2.5 billion a year. The optimal approach would be where a portion of the investment demand would be satisfied by domestic savings (currently growth potential is estimated at \$370 million – 5% GDP). Other portions would be realised by attracting: domestic commercial and public resources; and foreign investments. The remainder would be implemented at the expense of resources from international development institutions.

Agreements on major target investments in Tajikistan from Russia and Kazakhstan could be a part of the package of measures in the accession of Tajikistan to the CU.

In addition, for the purpose of accumulating funds and building confidence in the banking sector, investments are possible from Russian and Kazakh banks in the banking sector in Tajikistan. This will simplify the problem and at the same time reduce the cost of cross-border transfers and allow people to accumulate funds and invest them effectively in the national economy.

Support for the state budget – Currently the state budget of Tajikistan has a surplus; however, without the support of international institutions in the framework of the development assistance programmes, the budget would be deficit. At the SES accession stage Tajikistan may need a certain amount of transfers to maintain macroeconomic stability and meet the criteria of the three fundamental macro indicators: inflation, budget deficits and public debt. This support should be clearly conditioned with implementation of reforms in the public sector, related primarily to the reduction in tax breaks and subsidies.

Labour migration – Opening of the labour market of SES for citizens of Tajikistan will have a significant positive effect on the economy; however, a number of measures are required aimed at improving the quality of human resources, including:

- Strengthening the existing system of vocational training to improve the skills of migrants;
- Active policies in the labour market of Tajikistan in order to increase the attractiveness of employment in the national economy, especially for skilled workers;
- Public policy on export of labour resources to support temporary labour migration;
- Attractive conditions for the return of migrants to their home;
- In order to prevent outflow of specialists with higher education, some jobs may be subsidised as temporary labour migration policy measure.

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4

Labour Migration and Human Capital in Kyrgyzstan and Tajikistan: Impact of Accession to the SES

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The oil-rich economies of Russia and Kazakhstan started growing in the 2000's, and the consequence was a rapid rise of labour migration in the post-Soviet space. Within a decade labour migration became a highly visible phenomenon with significant economic and social consequences. It completely redefined the state of the economy in a number of post-Soviet republics, most notably Tajikistan, Kyrgyzstan, and Moldova. Migrant flows and remittances have also become an important factor for Uzbekistan, Armenia, and Ukraine. In the recipient countries, massive inflows of migrants caused social unease.

A redefinition is therefore required of the approach to the regulation of migration processes in the post-Soviet space. Russia and Kazakhstan are natural centres of attraction for migrant workers from Kyrgyzstan and Tajikistan. As the latter republics ponder on the issue of acceding the Customs Union (CU) and the Single Economic Space (SES), the potential benefits of ‘civilizing’ labour migration might be large. As we will show, they could account for 40-50% of the overall impact on the respective economies.

This paper is based on two comprehensive reports by the Eurasian Development Bank’s (EDB) Centre for Integration Studies, namely ‘Impact of Kyrgyzstan’s Accession to the Customs Union for the Kyrgyz Labour Market and Human Capital’ and ‘Economic Impact of Tajikistan’s Accession to the Customs Union and Single Economic Space’. The complete versions, available in Russian, contain a full description of research methodology and the relevant body of literature¹.

The paper is set out as follows. We start by portraying the large body of migrant workers abroad, including characteristics of their demography, occupations, education levels, income, and levels of money transfers. We proceed to highlight the importance of established social networks abroad, which became an organizing force of labour migration to Russia and Kazakhstan. We then outline potential consequences on migration of Kyrgyzstan’s accession to the Custom Union. Following that, we switch to Tajikistan and present results of modeling of the impact that Tajikistan’s accession to the SES might render on economic growth, migrants’ remittances, and productivity of labour.

KYRGYZ LABOUR MIGRATION AND HUMAN CAPITAL

Approximately 700,000 Kyrgyz citizens (15% of the population) are currently working abroad. This socioeconomic phenomenon virtually defines the present and the future of the Kyrgyz economy and the country’s sociocultural dynamics. Nonetheless, labour migration and related issues – such as the development of human capital, brain drain, and the role of diasporas and social networks – remain an extremely under-researched problem (Vinokurov, 2013).

We combine a macroeconomic, microeconomic, and sociological (both quantitative and qualitative) approach to assess the state of labour migration, and its effects on Kyrgyzstan’s human capital. We also assess the potential impact of Kyrgyzstan’s accession to the CU (Belarus-Kazakhstan-Russia) and SES on: Kyrgyz labour-resource flows; money transfers and labour-market environment;

¹ EDB Centre for Integration Studies (2013a, 2013b). Complete Russian versions, executive summaries in English and respective presentations are available online at <http://eabr.org/e/research/centreCIS/projectsandreportsCIS/>. These reports serve as the source of all figures in this paper, if not mentioned otherwise. We also use two further reports (EDB Centre for Integration Studies 2011, 2012) on labour migration to supplement data and argumentation.

institutions and migratory networks; education system; and workforce training.

The sociological research was based on quantitative and qualitative opinion polls. The aim was to gather information for studying and identifying the cause and effect of labour migration from Kyrgyzstan to Russia and Kazakhstan. Information was also obtained on the benefits and costs of migration, existing barriers, problems and workers' remittances. The geography of quantitative research covered Russia (Moscow and Moscow region), Kazakhstan (Almaty) and Kyrgyzstan (Bishkek, Osh, Chui, Issyk-Kul', Naryn, Batken, Talas, Jalal-Abad, Osh regions). Qualitative research was based on in-depth interviews with migrant workers from Kyrgyzstan (all of the above regions) to Russia (Moscow and Ekaterinburg) and Kazakhstan (Almaty), as well as migrants who have returned to Kyrgyzstan.

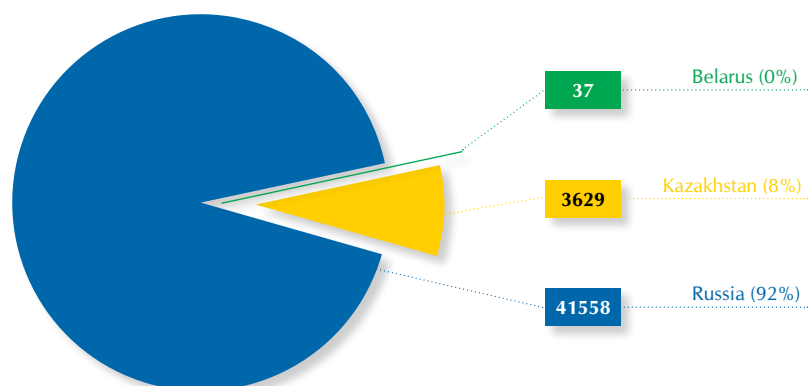
Profile of the statistically-average migrant worker

According to data published by Kyrgyzstan's National Statistics Committee, in 2011 there were 457,000 Kyrgyz migrant workers. Expert estimates of the number of migrant workers ranges from 620,000 in 2010 (WB, 2011) to 1,000,000 in 2012². There are significant discrepancies between the various estimates of the total number of migrants from Kyrgyzstan to CU countries. This further complicates the process of adopting the appropriate decisions and adapting measures with respect to migration regulation.

Official data allows conclusions to be made on the main vector of labour migration – 92% of external migrants work in Russia, while most of the rest is employed in Kazakhstan (see Figure 4.1).

Figure 4.1.
External migration
of Kyrgyzstan's
population in 2011,
by country

Source: National
Statistic Committee
of the Kyrgyz
Republic, 2011



² E.g. www.fergananews.com/news.php?id=19180

The main factors determining popular migratory movements from Kyrgyzstan to Russia and Kazakhstan are the persistent differences in income and labour demand. If the main ‘discouraging’ factor experienced by migrant workers from Kyrgyzstan to both Russia and Kazakhstan is the low income level and high unemployment in Kyrgyzstan, the main ‘encouraging’ factor can reasonably be called the growing labour demand in Russia and Kazakhstan.

**N., 48 years old, worked at trade pavilions
in the suburbs of Moscow and Moscow
proper from 2007 to 2011:**

“In Bishkek, I worked as a middle-school geography teacher. I moved to my sisters in the Moscow suburbs because I had to feed my family, and get medical treatment for my husband. Now I’ve returned, bought a plot of land... we’re building a 3-room house, we’ve opened a grocery pavilion, and my son is finishing university. Working in Russia definitely improved my family’s financial situation. If I had continued working at the school, there wouldn’t have been enough money for anything, and there’d be no house – not even in 30 years’ time.”

**A., 45 years old, working
in the service sector in Almaty
(Kazakhstan) since 2006:**

“In Kazakhstan, the working and living conditions are better. The money that I earn is enough to cover my housing costs, food, vacations, assistance for my relatives and son... On a single paycheck, for example, I can travel to any country, whereas in Kyrgyzstan, I’d have to work for an entire year or at least half a year in order to go somewhere.”

Differences in per capita GNP represent the predetermining factor in forecasting migration trends. However, their value coefficients are of greater significance to the originating country than the destination country. This means that in this region the “discouraging” factor is much more important than the “encouraging” factor; and this must be taken into consideration when making decisions on the regulation of migration processes. Our calculations established that deterioration in the economic indicators of the originating country is directly linked to emigration growth – if per capita GNP drops by 1%, emigration increases by 0.65–0.77%. The following factors are also of major significance to Kyrgyz citizens considering emigration:

- differences in income levels between Kyrgyzstan and recipient countries;
- living conditions, in particular, access to the healthcare system and the quality of medical services;
- distances between the countries, both physical and cultural; and the
- presence of well-established expat communities abroad.

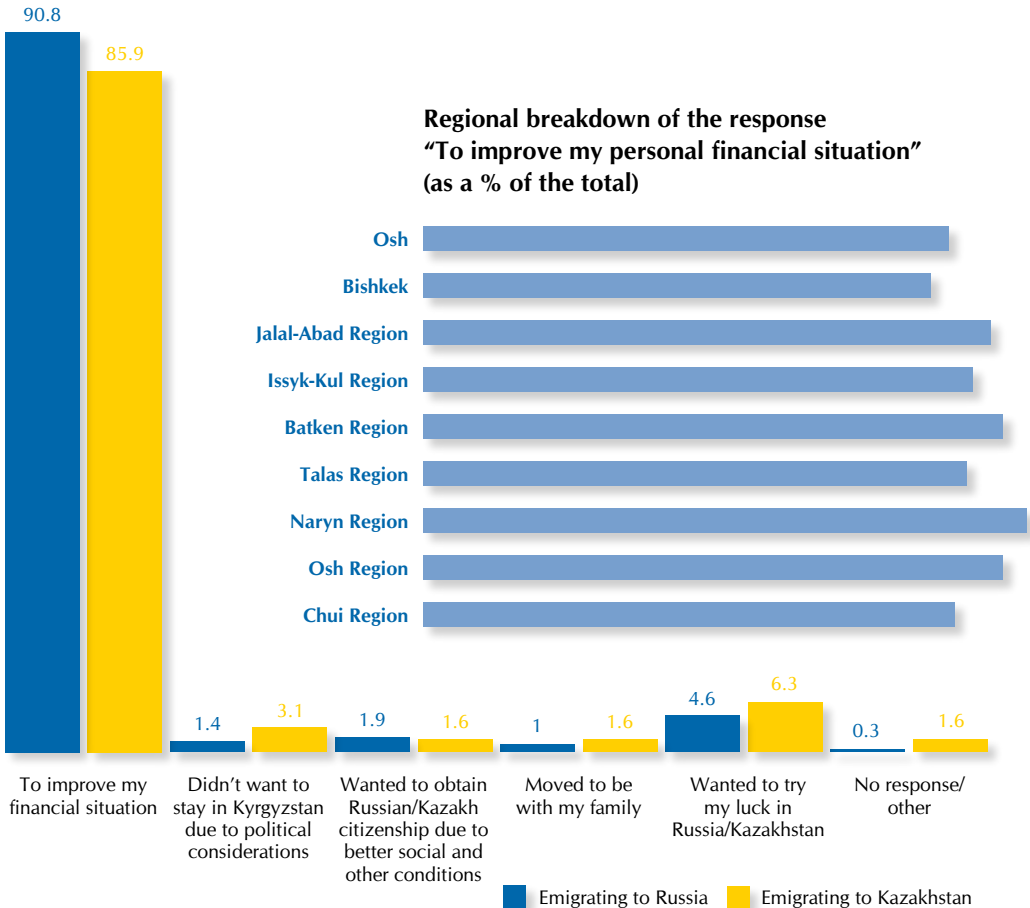
Demographic and quantitative sociological assessment allows us to define the profile of the statistically-average migrant worker. The people most susceptible to migration are: aged up to 35 (average age is 29); coming from small families (1-2 people); and living in Chui Region and the three southern regions (Batken, Osh and Jalal-Abad). Interregional development imbalances make a big difference in terms of the decision to emigrate. Residents of the Osh and Jalal-Abad regions express a high level of preparedness to move to another region or country in order to find work (see Figure 4.2). This is due to the challenging economic environment in the southern part of the country associated with: its limited

Figure 4.2.

Reasons for labour migration

Source: EDB Centre for Integration Studies, 2013a

What was your purpose in emigrating to Russia/Kazakhstan?



supply of arable land; scarce opportunities for livestock rearing; and low level of industrial development. Chui Region (Bishkek) occupies a dominant position, chiefly by virtue of the fact that it serves as a transit point for departures from the country. This correlation between regional development and the desire to leave the country is confirmed by the findings of our sociological research. It indicates that the greatest motivation for migrating for the purpose of improving personal economic situation (94-100%) is primarily expressed by residents of the country’s southern regions. The development of these regions, combined with youth employment policy, could be used therefore as an instrument for the regulation of migratory flows from Kyrgyzstan.

Based on the results of the calculations we made using the probit regression method, the determinants of labour migration were revealed to be wage level, unemployment rate, household income, age and level of education. An increase in the wage differential between originating country and destination country increases the likelihood of migration. An increase in regional unemployment indicators also leads to a higher likelihood of emigration. When the unemployment level reaches 20%, the likelihood of emigration climbs to 0.017 (a 70% increase over 6-percent unemployment). Per capita household income and age have a negative correlation; and where the values of these variables climb, the likelihood of migration falls.

Social networks are key; state bodies are not

The presence of social networks has emerged as an additional “encouraging” factor for those wishing to emigrate for wage-earning purposes. A significant role in the decision to emigrate, and the choice of ultimate destination, is played by

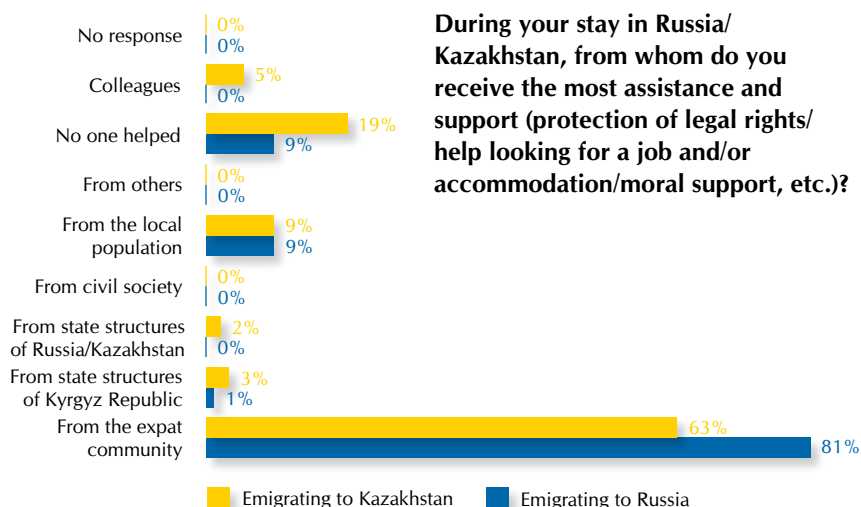


Figure 4.3.
 Sources
 of Assistance and
 Support

Source: EDB Centre
 for Integration
 Studies, 2013a

social networks through acquaintances or relatives. For 90% of migrant workers emigrating to Russia, and 78% of those emigrating to Kazakhstan, the local presence of relatives, friends, acquaintances and compatriots was crucial in their decision to emigrate from Kyrgyzstan for the purposes of employment. In response to the question of who helped the migrant workers in the destination country in terms of protecting their legal rights, looking for work and accommodation, and providing moral support, the great majority of surveyed migrants (81% for Russia and 63% for Kazakhstan) answered that help came from the local expat community (see Figure 4.3). This confirms the importance of social networks.

At the same time, we observed an extremely low level of engagement and support by state agencies, both in the originating country and destination country – less than 3% of all respondents received assistance from them. Therefore in the event of Kyrgyzstan’s accession to the SES, state and intergovernmental agencies, as well as non-governmental organisations active in the area, would be well advised to establish relationships with expat migrant communities. They are capable of acting as institutional partners in the implementation of various initiatives, first and foremost, those aimed at improving systems for the notification, support and legal protection of migrant workers.

IMPACT ON THE BROADER ECONOMY OF KYRGYZSTAN

As with any complex socioeconomic phenomenon, there are both positive and negative consequences of labour migration on the broader national economy. The overall framework is presented in *Figure 4.4*.

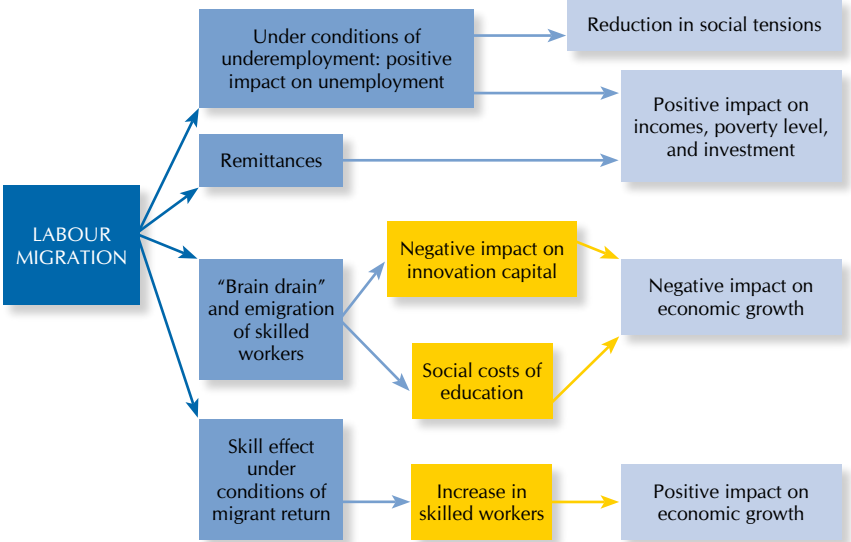


Figure 4.4.
Labour migration
and the broader
economy: multiple
channels of impact

Source: EDB Centre
for Integration
Studies, 2013a

The main positive factor for Kyrgyzstan remains money transfers by migrant workers. The total in 2011 was \$1.7 billion excluding transfers made via unofficial channels according to statistics of the National Bank of the Kyrgyz Republic. The transfer-to-GDP ratio has been sharply climbing since 2004, and the growth trend of this indicator continues. It reached 25% in 2010 according to official data (see Figure 4.5). This data is roughly consistent with World Bank estimates of personal transfers and compensation of employees, received by Kyrgyzstan in 2011, which were 28.9% of GDP (WB, 2012).

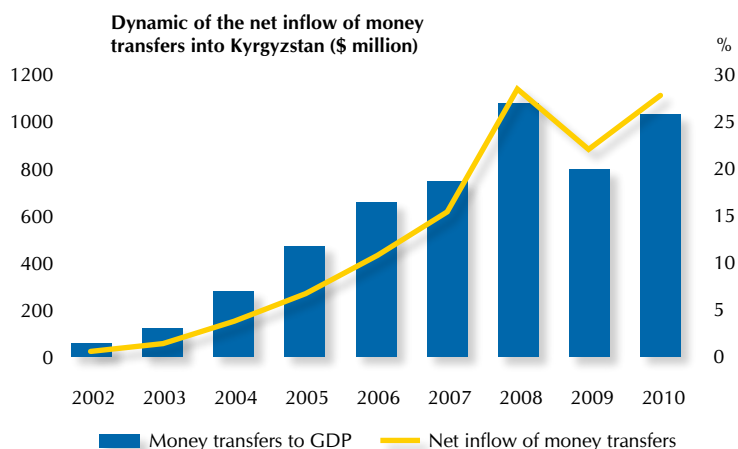


Figure 4.5.
 Net inflow
 of money transfers
 into Kyrgyzstan

Source: National
 Bank of Kyrgyzstan,
 2011

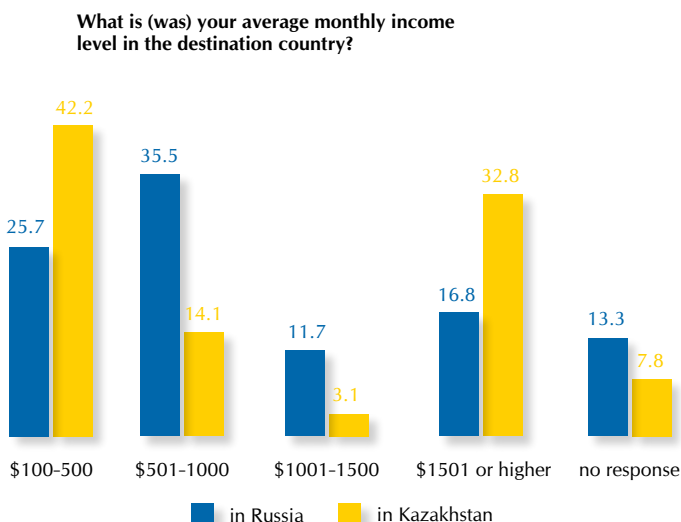


Figure 4.6.
 Average monthly
 income of Kyrgyz
 labour migrants
 in Russia and
 Kazakhstan

Source: EDB Centre
 for Integration
 Studies, 2013a

Within our study 45% of those surveyed send 30-50% of their earnings home every year; and 41.4% of surveyed migrant workers transfer an average of \$200 to \$500 monthly. Income levels of migrants vary significantly (see Figure 4.6), as they fill very different niches in the recipient economies both as unqualified and qualified labour.

In Russia and Kazakhstan demand for foreign labour comes from the same sectors, though small differences exist in terms of scale. In Kazakhstan most migrant workers are employed in retail (41% of respondents), services (16%), and agriculture (5%). In Russia construction, industry, and services are the primary employers of Kyrgyz migrants (see Figure 4.7).

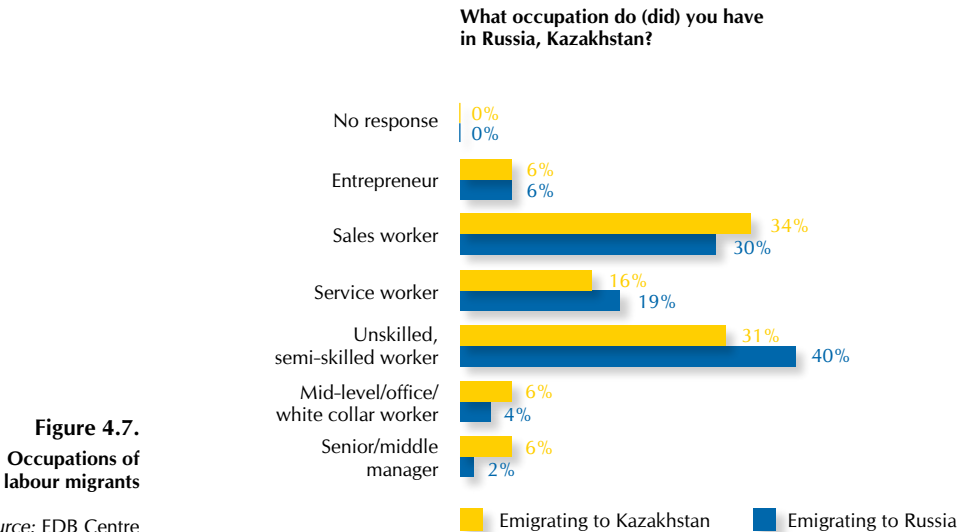


Figure 4.7.
Occupations of labour migrants

Source: EDB Centre for Integration Studies, 2013a

Ch., 39 years old, works in the sales sector in Almaty (Kazakhstan) since 2008:

"From Kazakhstan, hardly anyone sends money to Kyrgyzstan via the banking system. We either take it ourselves or give it to acquaintances to pass on. There's also a well-established and reliable system of transferring money by a network of taxi drivers from Almaty to Bishkek. It costs about 10 dollars..."

Kyrgyz workers are primarily engaged in unskilled labour. This is despite the fact that more than 40% of the country's migrant workers have a post-secondary education, whether complete or incomplete (see Figure 4.8). Therefore there is a discrepancy between education levels and actual jobs undertaken by Kyrgyz labour migrants.

Money transfers received in Kyrgyzstan are primarily diverted for consumption purposes, and only to a lesser extent used as investment

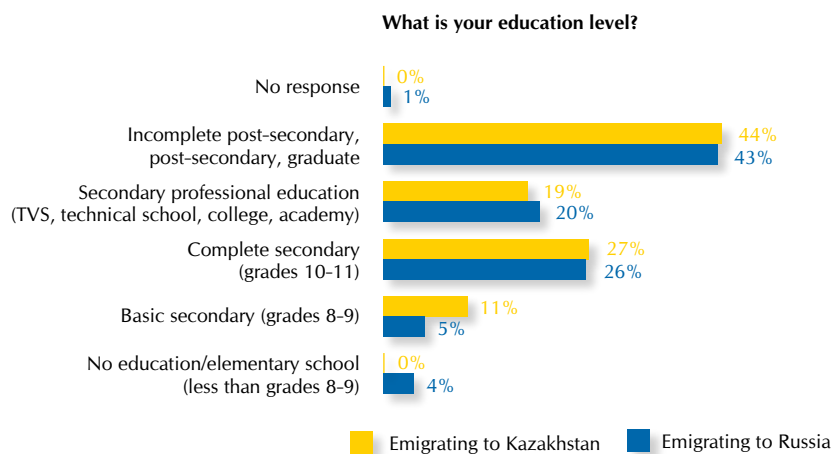


Figure 4.8.
Education level

Source: EDB Centre for Integration Studies, 2013a

resources. However, small investments are currently on the rise in the development of small to medium sized businesses, such as in the retail sales sector.

Labour migration has a largely positive impact on the Kyrgyz economy and society through the channel of money transfers. The most visible negative impact is certainly connected to brain drain and the erosion of the qualified workforce at home. It happens not only due to temporary labour migration but also through permanent migration of qualified workers such as engineers, doctors, teachers, agronomists. Kyrgyzstan faces a critical situation caused by the simultaneous reduction of the country's production and innovation potential. This could cause long-term socio-economic problems including poverty and low return on educational expenditure (KR, 2011). An economic downturn could lead to security problems and regional conflicts. It could result in creeping migration from neighbouring countries, including China; and could also pose a threat in terms of the increased influence of religious fundamentalism, and higher drug-trafficking flows into Kyrgyz territory.

It remains unclear what percentage of migrant workers are returning to their homeland, and how the process of reintegrating into the country's labour market is unfolding. Our survey demonstrated that 44% of Kyrgyz citizens residing in Russia have long-term plans for working in Russia (33% in Kazakhstan), and 18% have short-term plans for working in Russia (8% in Kazakhstan) (see Figure 4.9). The majority of respondents plan to return to Kyrgyzstan. Roughly one-fifth of all respondents do not want to work again in Russia or Kazakhstan, and only 6% and 9% (respectively) want to remain in Russia and Kazakhstan on a permanent basis.

**What are your future plans with respect
to Russia/Kazakhstan?**

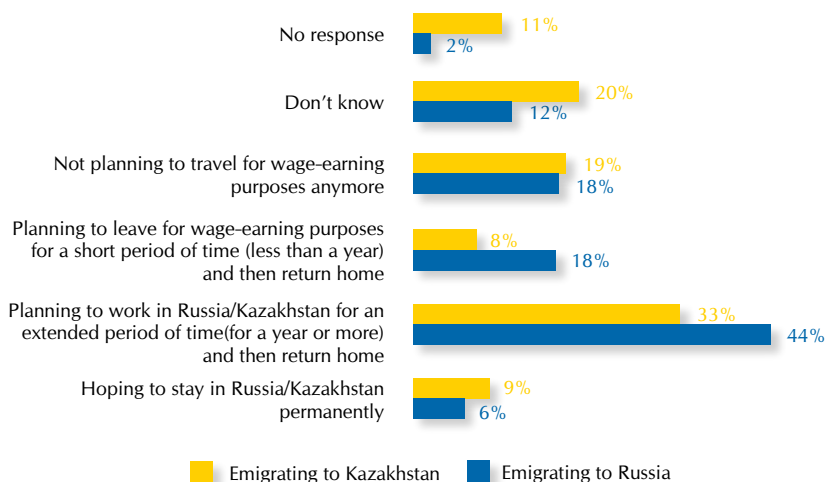


Figure 4.9.
**Plans with respect to
labour migration**

Source: EDB Centre
for Integration
Studies, 2013a

The return of migrant workers to Kyrgyzstan is projected to have a positive effect on development of the country's human capital. This is due to the repatriation of specialists with the newfound competencies and skills gained in the countries of immigration. Family relationships are the main reason for migrant workers returning home (58% for Russia and 34% for Kazakhstan). The second reason is the desire to open one's own business and apply newfound skills in Kyrgyzstan, which applies more to Kazakhstan (31%) than Russia (17%). This may be due to the greater ease of establishing contacts, finding partners and suppliers, and shipping goods from Kyrgyzstan to Kazakhstan than to Russia. The proximity factor seems to be important in expanding business connections.

ACCESSION TO THE CUSTOMS UNION: POTENTIAL IMPACT ON KYRGYZ LABOUR MIGRATION

Over the last few years the Customs Union and Single Economic Space, uniting Russia, Kazakhstan, and Belarus, has become a set of functioning rules and institutions. Kyrgyzstan has taken the political decision to join the CU and SES, and is now working toward that goal. The accession date has not been settled yet, but is estimated to be January 1, 2015.

The SES package includes two agreements regulating labour migration within the union: the 'Agreement on the Legal Status of Migrant Workers and Their Family Members'; and the 'Agreement on Cooperation among Member States on Counteracting Illegal Labour Migration from Third Countries'. The first agreement is more important as it grants national status to labour migrants in the

respective countries. It includes: the abolishment of licenses and permissions to work; and the granting of social and other rights to migrants and members of their families (medical care, education, etc.; pensions are not yet covered – EDB Centre for Integration Studies, 2012).

Our forecast of labour migration from Kyrgyzstan to CU countries indicates an annual long-term growth in labour-migration of 3.5%. However, the growth trend of migratory flows will to a large extent depend on Russian and Kazakh migration policy. This depends on the demographic projections and economic-development trends of these two countries. According to the baseline scenario, if Russia receives 8 million immigrants in 2010–2030, the total share of immigrants from Kyrgyzstan will be approximately 44,000 per year (for methodology of calculations, see EDB Centre for Integration Studies, 2012).

The main barrier to legal labour migration is the difficult process of registering a person's legal stay in the country of immigration. The current system of quotas in Russia, and their constant downscaling, is a counterproductive solution. It manifests itself in the rising number of illegal migrants. The foreign workforce in Russia in 2011, according to Russian Federal Migration Service data, totalled about 9 million (including approximately 500,000 from Kyrgyzstan). In 2011 the Russian Government established a maximum number of migrant workers of 1.7 million. In Kazakhstan labour-migration regulatory policy is based on recognition of the temporary nature of the phenomenon. The procedure for issuing permits for the utilisation of migrant labour is geared towards the gradual replacement of foreign workers by national personnel. This includes using the corresponding employer investments. Labour migration in Kazakhstan has been spontaneous; and there are many legislative gaps, which have become administrative barriers hindering labour migration. Some of these problems could be solved by: establishing a system governing the free movement of workers; abolishing permits conferring the right to engage in labour activity; and improving notification about the labour markets and administrative procedures in place in CU countries.

The main problems of labour migration, in the opinion of the migrants themselves, are financial difficulties (20% in Russia, 15% in Kazakhstan), and complications looking for work (16% in Russia, 17% in Kazakhstan). With respect to problems with housing and public-utility conditions, a gap is observed between Russia and Kazakhstan. The conditions are more challenging in Russia than in Kazakhstan (15% in Russia, 7% in Kazakhstan), while problems with the migration police are more prominent in Kazakhstan (24%) than in Russia (17%), (see Figure 4.10).

The key problems of migration are: the complicated system of migrant registration; the low level of migrants' legal awareness; inadequate professional training; poor knowledge of the Russian language; and insufficiently-harmonised legislation on employment terms and social security, which leads to low

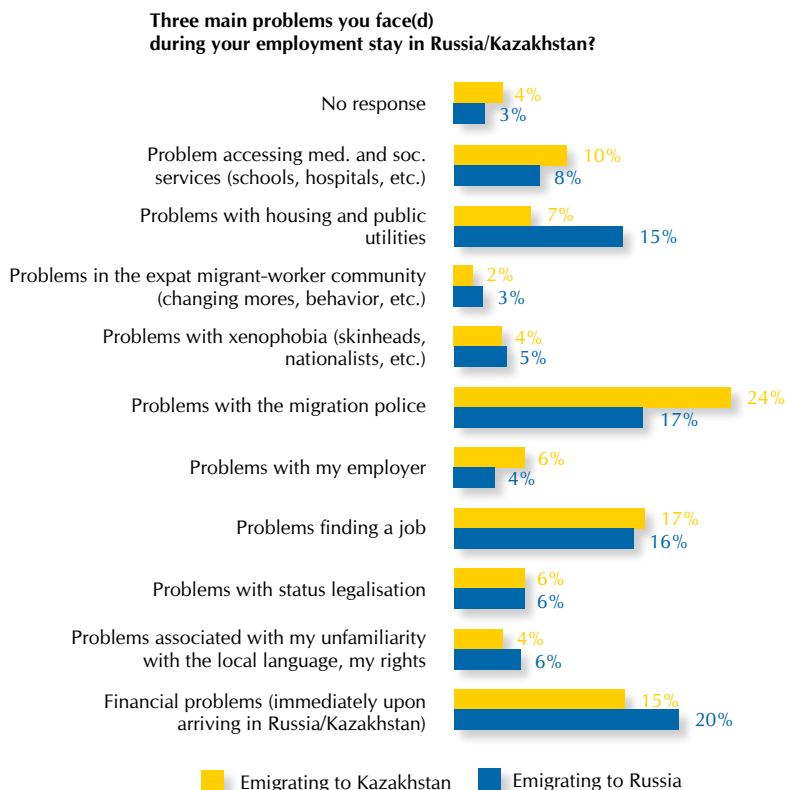


Figure 4.10.
**Main problems for
labour migrants**

Source: EDB Centre
for Integration
Studies (2013a)

migrant wages and workplace discrimination. The weak integration of migrant workers into the society of the destination country is the result of the absence of: specialised intergovernmental migration-regulation agencies; effective migration policy in the originating country; and an official notification system on employment opportunities abroad. Socio-cultural and economic differences between the local population and migrant workers cause a hostile attitude and the outbreak of conflicts.

The policy recommendation that we would single out, and make in the strongest possible way, is that Kyrgyzstan's accession to the CU and SES should proceed in full - without restriction on labour migration. If the labour component is excluded from the accession package, then the most substantial component of its positive impact would wither. Kyrgyzstan's accession to the CU and SES should include full access to the SES labour market, as prescribed by the aforementioned agreement. SES membership provides migrant workers from union countries with national status in relation to both job placement and

access to social services for the migrant and family members. This would lead to: multiple gains through channels of taxes (recipient countries)³; improved criminal situation (recipient countries); lower state expenditure (recipient countries); increased money transfers (donor country); and an improved social condition vital for the well-being of migrants.

Simultaneously, it is important to make arrangements to secure the external borders of the CU in order to restrict the movement of the citizens of third countries (CU non-member states), and ensure the security of CU countries.

In the realm of labour migration, the Kyrgyzstan's accession should be beneficial also as concerns capital flows. The flow of investments from the more economically-developed Russia and Kazakhstan to Kyrgyzstan would encourage job creation, household income increases, and regional development. This in turn could become a deterrent against external migration.

LABOUR RESOURCES OF TAJIKISTAN AND THE EFFECTS OF MIGRANTS' REMITTANCES

Labour migration in modern Tajikistan is a defining phenomenon of its economic and social life, as well as a critical tool to alleviate poverty.

More than 98% of migrants from Tajikistan prefer Russia and its largest cities, especially Moscow (about 60%). According to the EDB Centre for Integration Studies report, between 1994 and 2005 the number of Tajik workers in Russia did not exceed 40,000. But then in 2005 the migration from Tajikistan began to grow exponentially, reaching a peak in 2008 of about 400,000. The crisis of 2008 and the subsequent stagnation of the economy led to a reduction in the number of migrant workers, and they stabilised at 300,000 (EDB Centre for Integration Studies, 2011).

In addition to the flow of legal immigration, a large number of illegal migrants from Tajikistan work in Russia. In 2010, of the migrants working in Russia 268,000 were legal and 650,000 illegal, which is more than 70% of the total number of migrants from Tajikistan (EDB Centre for Integration Studies, 2013, b).

**Ch., 48 years old, migrant worker
in Kazakhstan since 2007,
working at a firm in Almaty:**

*“... All migrants are waiting for
Kyrgyzstan to join the Customs Union
– all of these migration issues would
be solved, allowing people to work
without hindrance in CU countries.
I think the opportunity for workers to
move freely will change the current
situation of having to constantly leave
the country and come back again,
register every three months, and so
on. Kazakhstan is a CU member and
Kazakhs are free to work in Russia as
they like, which is very convenient.”*

³ We estimate elsewhere that the gain for Russian federal budget stemming from the legalisation of Kyrgyz and Tajik labour migration will be in excess of 40 billion roubles a year, or approximately \$1.3 billion (EDB Centre for Integration Studies, 2011).

If we analyze the composition of migrants, it is important to note that 69% of current and 82% of returning migrants lived previously in the countryside. In addition, 90% of migrant workers come from the Sogdi and Khatlon regions and centrally administered districts of Tajikistan – the most populated areas of the country. Regarding age groups, the highest involvement in labour migration is observed in the 25 to 34 age group – 18% (32% for men).

Key factors affecting the probability of migration in Tajikistan are unemployment and household poverty. This is the same as in Kyrgyzstan. Unemployment is a major push factor that motivates people to a higher level of mobility. Remittances are an important source of income for households and budgets of labour resources donor countries. An assessment of the size of remittances is presented in *Table 4.1*.

Table 4.1.

**Remittances
received by the
country in 2010
(\$ million and their
share in GDP)**

Donor countries	Remittances received by the country in 2010 (\$ million)	GDP (\$ million)	Share in GDP
Tajikistan	2960	6522	45%
Kyrgyzstan	1160	5919	19.6%
Kazakhstan	132	186198	0.07%
Belarus	375	55136	0.68%

Source: EDB Centre
for Integration
Studies (2012)

As can be seen from the table, migrant workers remittances reach almost \$3 billion, which is about 45% of Tajikistan's GDP. Tajik migrants transfer the largest amount of remittances compared to other member states and candidates participating in the SES, both in monetary terms and as a share of GDP.

Short-term savings (for up to 6 months) are 12% of transfers, and a further 11% of transfers are deposited in the form of long term savings (for longer than 6 months). Average savings of transfers are therefore 23%, which is a lot in relative terms and a large amount in absolute terms. At the same time, 98% of households do not keep all of their savings in the banks. So despite the great potential for financing investments, the banking and financial sectors have failed so far to offer savings' instruments that would be interesting for a large number of recipients of remittances. This is despite the fact that 87% of migrants send money home through banks and specialised organisations.

The majority of households (92.8%) that receive remittances use the major part of transferred money to provide basic household expenses. All households that receive remittances in goods use them for consumption. On average 57% of the money received from relatives of workers from abroad is spent on urgent needs.

It is important to note that only 33% of workers have a professional education, and 12% have higher education. The majority of Tajik migrants are unskilled and young. Workers without professional education, and who are younger than 35, comprise two-thirds of current workers and more than half of returning migrants.

Tajik migrants tend to work in sectors that consume low-skilled labour, such as construction, trade, and utilities (see Figure 4.11). About 70% of educated workers are engaged in a variety of simple unskilled labour or craft (small manual production) and the sale of related products. Another 20% of migrants with higher education work in retail, the service sector, or in industry.

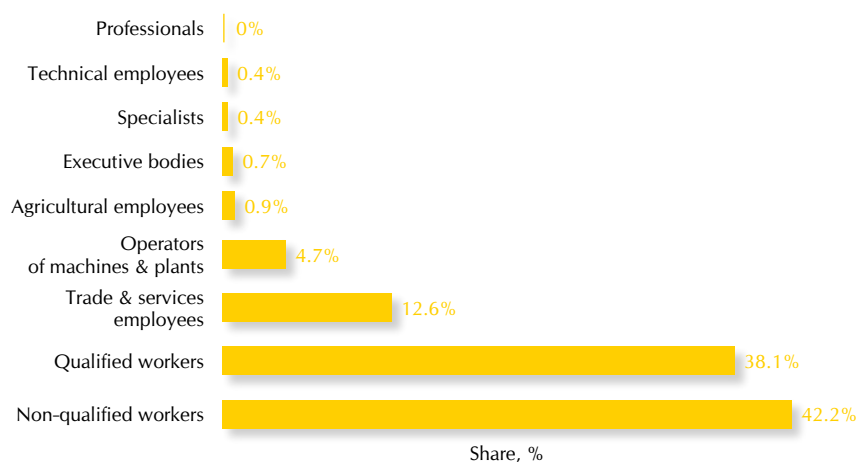


Figure 4.11.
 The distribution of
 Tajik workers by
 occupation (2009)

Source: EDB Centre
 for Integration
 Studies (2013b)

EFFECTS OF TAJIKISTAN'S ACCESSION TO CU AND SES: PROSPECTS AND SCENARIOS

In the case of Tajikistan's accession to the SES, and accession to the 'Agreement on the legal status of migrant workers and their family members', a significant number of illegal workers will become legal. This will increase the income of the Russian budget through the payment of income tax. Each year the Russian budget loses between 10 and 40 billion roubles due to income tax on individuals, as migrants working illegally do not pay taxes (EDB Centre for Integration Studies, 2012). In addition, an increase in revenue budget of Russia and other SES member countries may then occur by reducing the cost of curbing illegal migration. Its level is reduced by the cancellation of most barriers to foreigners working legally, and by illegal migrants becoming legal.

The removal of barriers within the labour market is more likely to increase the extent of employment legalisation, rather than causing an increase in Tajik labour migration. Expert estimates indicate that Tajikistan's accession to the CU would only generate a small growth in the number of migrant workers. For migrants, the removal of official requirements will result in longer migration periods. In total, on the basis of expert figures, Tajikistan's CU accession will result in a migration surge of 10-15%.

After Tajikistan's accession to the CU and the adoption of the relevant labour migration agreements, the migrants' salary will almost be the same as Russian migrant-nationals. However the influx of workers onto the labour market might cause a drop in the equilibrium wage. The growth estimate for migrants' remuneration after Tajikistan joins the CU ranges from 9% to 28%.

Growth estimates for cash remittances after Tajikistan joins the CU are in the 15-25% margin (see Table 4.2). This translates into a potential growth in remittances of up to \$3.4 to 3.7 billion, or a GDP cash remittances share of 49 to 53% (assuming GDP growth is 7% a year) (EDB Centre for Integration Studies, 2013, b). It must be noted that all calculations are based on the assumption that the economic conditions in the recipient-countries (mainly Russia) will feature a sustained positive trend.

Table 4.2.
Growth in volume
of cash remittances
from Tajik migrant
workers (forecast)

Source: EDB Centre
for Integration
Studies (2013b)

Growth in migrant's salary	Migration increase		
	5%	10%	15%
10%	15%	21%	27%
15%	20%	27%	32%
30%	36%	43%	49%

Cash remittances are currently primarily used for consumption. This is critical to maintain and improve living standards, and to help alleviate poverty. They represent huge potential for savings growth and, therefore, for funding private investment. The growth potential for the funding of investment from people's individual savings already currently stands at approximately \$300 million. Accession to the SES would raise anticipated cash remittances by 15-25%, increasing growth potential to \$375 million, or approximately 5% of GDP. How much this potential will be used to finance investment depends on the banking system's ability to provide savings tools that will draw people's savings into the financial and banking system, and allow investment resources to accumulate.

Entry to the single labour market is one of the most important advantages of Tajikistan's potential SES accession. SES labour migration agreements are the

‘Agreements on the legal status of migrant workers and their family members’, and ‘Agreements on cooperation to counter illegal labour migration from third states’ (EDB Centre for Integration Studies, 2012). They are designed to unite the labour resources of those countries party to these agreements. They also establish an efficient and effective common labour market. The impact of these agreements is to weaken the main obstacles so that migrant workers can be employed.

Other key positive consequences of Tajikistan’s accession to the SES migration agreements are: to eliminate the deficit of labour resources in Russia; and reduce the labour market in Tajikistan, which cannot create enough jobs for young workers.

Migration plays a crucial function in the alleviation of poverty. It creates a secure social environment, and ensures sustainable development. Equally, the migration of skilled and qualified workers can result in the loss of the country’s skilled employees, which can have a negative impact on the pace of economic growth. A balanced policy needs to make use of the advantages that can be gleaned from migration. These are through a growth in people’s income from cash remittances from abroad, and the acquisition of skills and qualifications during employment abroad. They need to be combined with an active policy to create new productive jobs in the country. The jobs would retain highly-skilled and qualified personnel and further enhance the basis for stable economic growth. The establishment of favourable business conditions, and the securing of investment into the national economy, will enhance the creation of new innovative jobs and heighten competition with jobs based abroad.

State labour export policy should be implemented to support temporary labour migration. It is important that those opportunities provided under the SES agreements are put in motion, to ensure that migrant workers are supported and protected. There is a need for talks on: expanding existing agreements towards ensuring full social security provision, including the portability of pensions; the mutual recognition of education diplomas and certificates; and access to initial vocational training in the host country.

However, along with the positive influence of the possible accession of Tajikistan to the SES there can be some negative consequences both for Russia and Tajikistan. For Russia the negative consequences are a possible decrease in the average level of wages, and the lack of incentives to modernise production in a situation with relatively cheap labour. In addition, a large flow of migrants leads to certain social costs relating to the adaptation and integration of migrants into the society of the recipient country, and the growth of xenophobia and social discontent.

The significant positive contribution of migration is the reduction of tension in the Tajik labour market. The negative impact is the archaic freezing of the

Tajik economic structure, and the lack of demand for any change in the power structure and the quality of governance. Positive and negative consequences for the labour market of Russia and Tajikistan in the case of Tajikistan's accession to the SES are presented in *Table 4.3*. It is noted that the relationship and significance of each impact of Tajikistan's accession to the SES requires additional data and research.

Table 4.3.
Consequences of the possible accession of Tajikistan to the SES

Source: EDB Centre for Integration Studies (2013b)

Consequences	For Russia	For Tajikistan
Positive	Positive impact on the labour resources' deficit problem.	Alleviating the problem of poverty. Alleviating unemployment. Transfer of knowledge and skills.
Negative	Decrease in the average wage, xenophobia, social conflicts, lack of incentives to increase productivity.	The outflow of skilled specialists. Lack of demand of changes in the quality of institutions and governance.

CONCLUSIONS

Labour migration is a defining phenomenon of Kyrgyzstan and Tajikistan's economies and societies. In this paper we have provided comprehensive results of sociological and econometric studies on the issues of labour migration, human capital, and the impact of SES accession.

In particular, we highlighted the role played by social networks abroad. They emerged as an additional encouraging factor for those wishing to emigrate for wage-earning purposes. A significant role in the decision to emigrate, and the choice of ultimate destination, is played by social networks through acquaintances or relatives. For 90% of migrant workers emigrating to Russia, and 78% of those emigrating to Kazakhstan, the local presence of relatives, friends, acquaintances and compatriots was crucial in their decision to emigrate from Kyrgyzstan for the purposes of employment. State bodies have failed so far to play a constructive role in labour migration processes.

Overall, the opening of the SES labour market for Kyrgyzstan and Tajikistan will have a substantial positive impact on the economy. However a range of measures is required that improve the quality of labour resources. These should include an improvement in current professional training to ensure that migrant skills and qualifications are raised. This should be supplemented by an active policy in Tajikistan's labour market, aimed directly at increasing employment opportunities in the national economy, mainly for highly-skilled and qualified personnel.

We stress that both Kyrgyzstan's and Tajikistan's accession to the CU should necessarily incorporate labour migration agreements that essentially provide migrants with national status. If the labour component is excluded from the

accession package then the most substantial component of the positive impact would wither.

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The Integrated Foreign Exchange Market in CIS: From Theory into Practice

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1. CREATING THE INTEGRATED FOREIGN EXCHANGE MARKET: BACKGROUND

For a long time the CIS exchanges and the International Association of Exchanges of the CIS Countries (IAE CIS)¹ have been taking steps to set up an

¹ The International Association of Exchanges of the CIS countries (IAE CIS) was set up in Moscow in 2000 in order to coordinate the development of organised financial markets in accordance with international standards. At present, IAE CIS has twenty member institutions, including 19 leading exchanges and one depository, from nine CIS countries.

The Moscow Exchange Group is an integrated exchange structure, which includes foreign exchange, money, stock, futures and commodity markets. It was set up in December 2011 as a result of the merger of Russia's two leading exchange groups – MICEX and RTS. The Group includes the Moscow Exchange MICEX-RTS ("Moscow Exchange"), the MICEX Stock Exchange, the National Clearing Centre, the National Settlement Depository and other institutions.

integrated foreign exchange market (IFEM). On April 25, 2003 the Council of the CIS Heads of Governments approved the blueprint for the establishment of an integrated foreign exchange space, which was proposed by the Moscow Interbank Currency Exchange (MICEX) and IAE CIS. This document provided for the creation of an IFEM in the CIS with minimal costs. The idea was to launch a mechanism of cooperation between central/national banks and currency/stock exchanges in the CIS, which would make it possible for these countries' commercial banks to become direct participants in a single foreign exchange space.

For various objective reasons (primarily because of the accession by some CIS countries to the WTO) this project had been suspended for some time before being restarted in 2010. In May 2012 the heads of the CIS governments approved the Blueprint for the Liberalisation of the Financial Services Market with the aim to simplify foreign exchange transactions and enhance cooperation between the CIS stock markets. On December 5, 2012 the Council of the CIS Heads of States signed the Agreement on Cooperation in the Establishment of an Integrated Foreign Exchange Market, which set forth the basic terms for providing CIS banks with equal access to the national foreign exchange markets of other CIS countries for the conduct of interbank foreign exchange transactions. The agreement envisages that each country should provide those banks from other countries that are entitled to conduct foreign exchange transactions with access to its national foreign exchange market on terms which are no less favourable than those provided to its resident banks.

The EurAsEC has a positive experience of adopting a similar IFEM Agreement. It was signed on January 25, 2006 and is already being used in exchange practices.

Organisational difficulties were caused by the lengthy approval and signature process and the need to adopt additional bylaws that were not included in the base agreement. In November 2009 resident banks of the EurAsEC countries that had joined the IFEM Agreement were provided with access to the Moscow Exchange currency market. However, the key condition for making this access available to a resident bank is the existence of an additional inter-institutional agreement on cooperation in the area of organising interaction between and providing informational support to IFEM participants between the Bank of Russia and the central/national bank of the respective EurAsEC member state. In 2010 these interinstitutional agreements were made between the Bank of Russia and the national banks of Kyrgyzstan, Belarus and Tajikistan. A similar agreement was signed with the National Bank of the Republic of Kazakhstan in April 2012. These instruments provide broad opportunities to ensure that EurAsEC/CIS banks mutual access to the integrated market.

2. THE MEANING AND ADVANTAGES OF IFEM

The debt crisis in a number of Eurozone countries made the benefits of integration somewhat doubtful. IMF Managing Director Christine Lagarde believes that this should be overcome. A more integrated and intertwined global economy can be very useful. However, new risks can emerge where finance has a global nature while the architecture for ensuring system stability remains predominantly national (Lagarde, 2012).

The financial and economic crisis has clearly shown the similarities in the behaviour of the CIS economies in stressful situations and fostered integration processes. In 2011 Russia's foreign trade with the CIS countries grew by 34%, to \$122.6 billion, and its share in Russia's overall trade turnover increased to 14.9%.

Regional integration mechanisms form a new international financial architecture and promote global financial stability. A regional mechanism helps to overcome the disorganisation of intraregional trade and investment flows caused by problems in small countries and thereby maintain general stability in the region (Kawai, Lombardi, 2012).

A single foreign exchange and financial space provides the CIS countries with an opportunity to more easily resolve certain challenges that are significantly harder to tackle when they act on a stand-alone basis. These include:

- the creation of high-capacity national financial markets with a diverse set of instruments and a gradual movement towards an integrated market;
- the strengthening of national currencies and the improvement of their role in domestic money circulation and mutual settlements, including a gradual reduction of the role of the US dollar;
- the creation of a single exchange space that promotes the free movement of investments in the CIS and an increase in cross-border payments in national currencies (including the rouble).

The advantages of the IFEM include the following:

- a reduction in foreign exchange risks as a result of the use of up-to-date exchange risk management systems;
- an increase in transparency and market liquidity and in the stability of the rates of exchange following the participation in trade organised by national banks (including central ones);
- a reduction in foreign trading participants' transaction costs as a result of the exclusion of intermediate currencies (the dollar and the euro) and the formation of narrow spreads in national currencies once all interested parties are involved in the trading.

3. THE DEVELOPMENT OF FOREIGN EXCHANGE MARKETS IN CIS AND PRECONDITIONS FOR IFEM CREATION

In 2009–2011 a number of important statutes were adopted to simplify foreign investors' operations in the Russian market and official agreements on the Single Customs Tariff and the Customs Code of the SES of Russia, Belarus and Kazakhstan were signed. The SES member states devised the Agreements on the creation of conditions in financial markets to ensure the free movement of capital and on the Agreed principles of the foreign exchange policy. These instruments provide the necessary preconditions to the development of integration processes in foreign exchange sphere and mutually beneficial cooperation between financial institutions.

The Bank of Russia, within the framework of the Agreement on the informational support to the Agreed principles of the foreign exchange policy, has already begun to publish on its website summarised data on the status of and outlook for the domestic foreign exchange market, specifying transactions in the national currencies of Belarus and Kazakhstan. In the first quarter of 2013 the average annual volume of foreign exchange transactions closed by Russian banks exceeded \$62 billion, however transactions with the national currencies of the CIS countries accounted for less than 1% of this.

Table 5.1.
Foreign exchange
transactions at IAE
CIS exchanges
(\$ billion)

Source: IAE CIS,
2013

Exchanges	2006	2007	2008	2009	2010	2011	2012
Baku Interbank Currency Exchange (BBVB)	1.9	1.9	2.8	2.5	0.9	1.3	0.9
Belarusian Currency and Stock Exchange (BCSE)	10	10.6	18.7	14.1	21.2	17	30
Kazakhstan Stock Exchange (KASE)	41.7	91.4	138.9	67.7	106.9	106.2	96.1
Moscow Exchange	955.9	1,494.3	2,680	3,001.9	2,616.3	2,901.2	3,760.5
NASDAQ OMX Armenia	0.4	0.9	1.1	1.1	0.8	0.8	0.8
IAE CIS	1,010.7	1,600.5	2,843.4	3,087.3	2,746	3,026.4	3,888.3

According to IAE CIS, in 2012 the foreign exchange trading volume of the association's members grew by 28%, to \$3.9 trillion (see Table 5.1). The Moscow Exchange accounted for almost 97% of the total foreign exchange turnover at IAE CIS. In 2012 the Moscow Exchange's FX market grew by 35% and this year by another 13%. In April the average daily trading volume exceeded \$20 billion (see Figure 5.1). The access to this highly liquid and technologically advanced segment opens broad opportunities for their CIS counterparts.

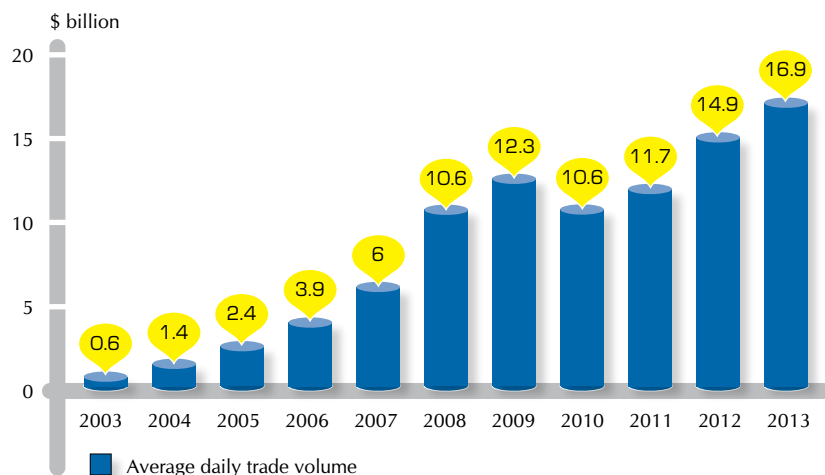


Figure 5.1.
Moscow Exchange's
FX market average
daily trading volume
(\$ billion)

Source: Calculated using the data from the Moscow Exchange (<http://rts.micex.ru>) and the Bank of Russia (<http://www.cbr.ru>)

Electronic foreign exchange markets are developing in a very dynamic fashion. They are also being modernised in a number of areas such as the advancement of technologies, the expansion of the customer base and the strengthening of regulations. New electronic systems appear in the global market that challenge conventional interdealer platforms and provide access to the foreign exchange market for a growing number of institutional and private investors. This requires that respective changes be made to the regulatory framework in order to reduce risks and protect new categories of investors.

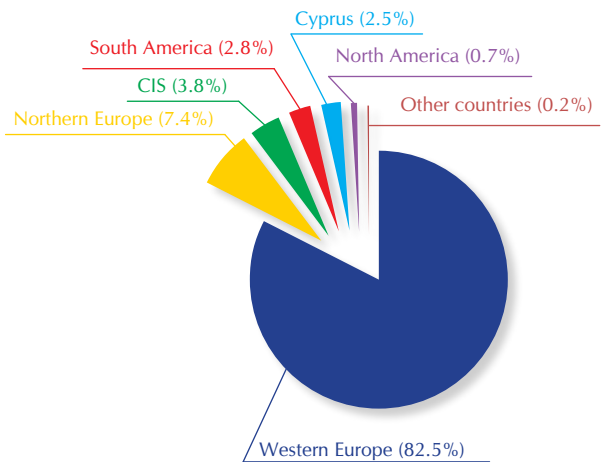
The American and European regulations governing OTC transactions (the Dodd-Frank Act and the MIFID) tend to favour organised markets. The new regulatory terms envisage the use of centralised clearing mechanisms and recommend that, among other things, transactions with standardised OTC instruments be effected in electronic/organised floors and compulsory reporting on OTC transactions be prepared.

The Russian laws are being subject to no less serious modifications. On January 1, 2012 the Federal law on organised trading took effect, setting the requirements for organisers and participants and the basic conditions of governmental control, as well as the Law on clearing and clearing activities, governing the creation of a central counterparty and a close-out netting mechanism in the Russian financial market. In 2013 governmental supervision is expected to include the brokerage foreign exchange market and other sectors of the non-banking financial market that remain unregulated at present. Experts are convinced that the adoption of a relevant law should make the relationships between brokers and clients more transparent and restrict the access to the market for unfair participants (Marich, 2012).

4. EXCHANGE INITIATIVES TO CREATE IFEM

An IFEM in the CIS will provide banks and financial companies with additional opportunities to enhance foreign trade and the flows of capital and labour. An organised foreign exchange market can be effectively regulated by national supervisory authorities. The Moscow Exchange considers this a promising project and is cooperating with interested partners from IAE CIS in order to ensure comprehensive use of the advantages of exchanges compared to the OTC, or unorganised foreign exchange market.

a) RUB/USD spot transactions



b) EUR/USD swap transactions

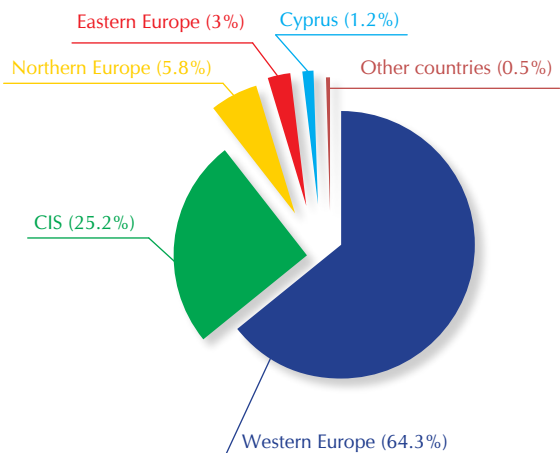


Figure 5.2.

Geographical breakdown of Russian interbank (a) USD/RUB spot transactions and (b) EUR/USD swap transactions, by non-resident counterparty's location (January 2013, %)

Source: Bank of Russia. Main indicators of currency circulation in Russia's domestic foreign exchange market calculated using the Bank for International Settlements' guidelines. <http://www.cbr.ru>

The National Clearing Centre has been operating as the central counterparty in the Russian foreign exchange market since late 2007. The advantages of the Moscow Exchange's FX market are high performance trading, clearing and settlement platforms, the continuous double auction, the market depth order book and settlement completion guarantees.

The CIS exchanges have similar priorities in their development: the improvement of corporate governance and risk management systems, the launching of the T+n settlement scheme, the use of the partial pre-deposition of funds and the launching of clearing through a central counterparty and more. All these factors make the integration of the CIS exchange market an important objective, one which envisages the creation of a single technological, trade, clearing and settlement space in the CIS and can produce synergetic effects in various areas of the financial sector.

The CIS countries have already occupied a certain niche in the Russian foreign exchange market. According to the Bank of Russia, in the geographical breakdown of interbank transactions closed by non-residents, those from the CIS accounted for 5-10% of cash transactions and 2-4% of USD/RUB FX swaps in 2012. In the EUR/USD pair the share of Russian banks' transactions with counterparties from the CIS countries was even higher. For swap FX transactions, for example, it stood at more than 25% in January 2013 (see Figure 5.2).

These data confirm that interexchange integration projects to provide mutual accesses to non-residents are in demand and that the formation of a regional financial centre is realistic.

4.1. Direct Access for EurAsEC/CIS Banks to Exchange Market

In accordance with the EurAsEC Agreement on Cooperation in Organising an Integrated Foreign Exchange Market, the Moscow Exchange is implementing a project to provide banks from the EurAsEC countries with access to trading at the exchange. In 2012 Interstate Bank (which has international status) was provided with access to trading and made its first transactions at the exchange.

In order to provide EurAsEC banks with access to the exchange and ensure their operations at it, a number of regulatory, organisational and technological issues needed to be resolved, including taxation for non-resident participants, the dispute resolution procedure, access technology and the selection of electronic data protection tools. After all the necessary agreements had been signed by the central banks of the EurAsEC countries, the Moscow Exchange launched pilot projects to open the exchange to Belarusian, Kazakh and Kyrgyz banks.

At present Russia has restrictions on the export of cryptographic data protection (CDP) tools that are used in trading terminals and electronic document

management (EDB) systems by the Moscow Exchange's FX market. In practice this restricts non-resident banks' access to foreign exchange. To tackle this problem, the Moscow Exchange decided to use alternative CDP tools, the export of which from Russia is not restricted (Microsoft CSP).

In January 2013 an access roadmap and process schemes to include EurAsEC banks in trade were completed. A second contour of exchange systems was developed for foreign banks to ensure the closure of transactions and data protection at the foreign exchange market.

On February 7, 2013 the Moscow Exchange provided access to its FX market for EurAsEC banks from Belarus, Kazakhstan, Kyrgyzstan and Tajikistan. Belarusian BPS-Sberbank was the first foreign bank to test the new exchange instruments, get access to trading and begin to conclude transactions in the IFEM. Another three Belarusian banks and one Tajik bank are in the process of getting access to trading. The exchange is also conducting a proactive search for the first pilot banks from Kazakhstan and Kyrgyzstan.

At the ceremony of opening the IFEM at the Moscow Exchange, Timur Suleimenov, Minister for Economy and Financial Policy of the Eurasian Economic Commission, said, "The integrated foreign exchange market project, which is being successfully fulfilled, is a vivid demonstration of the effectiveness of cooperation between interstate authorities, central and national banks and exchanges of our countries in forming a single foreign exchange space. I would like to note specifically that as a result of the project fulfilled by the Moscow Exchange participants get an opportunity, for the first time in the framework of the SES, to enter the integrated financial market with a licence from its national regulator and without the need to obtain a Russian foreign exchange licence" (MICEX, 2013).

4.2. Sponsored Direct Market Access

At present, non-resident CIS banks can also operate at the Moscow Exchange by making use of Sponsored direct market access, i.e. through Russian participants. They also have the opportunity to involve clients from their countries (via sub-broker accounts). The Direct Market Access (DMA) system provides non-resident clients with direct online information from the exchange, including quotations, and with the ability to become the clients of FX market participants as well as enter orders and conclude transactions through them.

The exchange launched a fully-featured DMA system with the ability to register clients in the trading system on February 13, 2012. The new access technology brought a significant increase in client activity. In 2012 the value of client transactions in Moscow Exchange's currency market totalled RUB 12.3 trillion and the number of clients grew from 12 to 3,500. By the end of 2012 client transactions exceeded 12% of the foreign exchange market as a whole and 22% of spot transactions. DMA enhances the liquidity of the exchange due

to the involvement of new categories of participants, including non-residents, brokers and individuals. By April 2013 the number of clients exceeded 5,000 (see Figure 5.3).

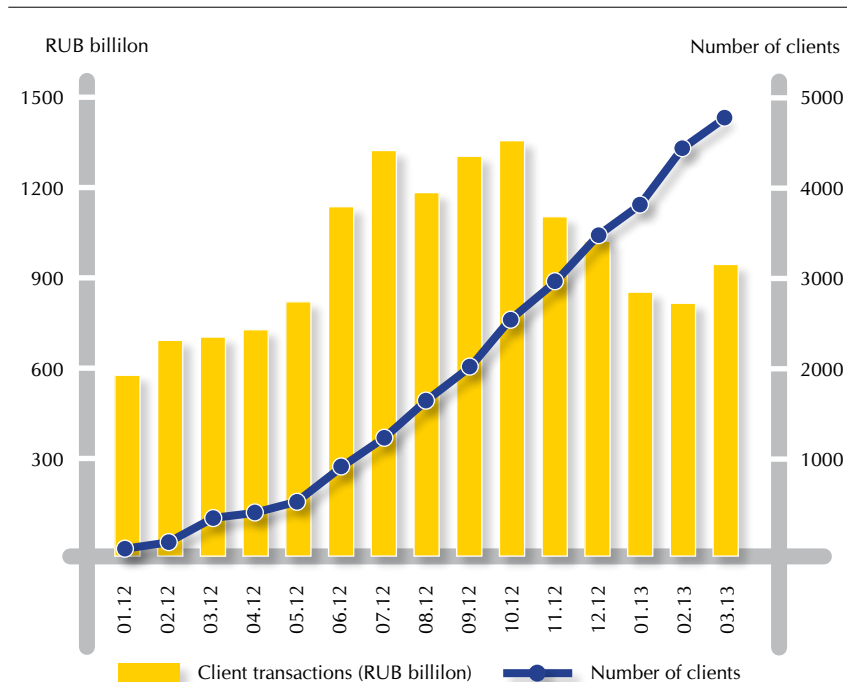


Figure 5.3.
Client transactions (RUB billion) and the number of clients registered in the Moscow Exchange's currency market

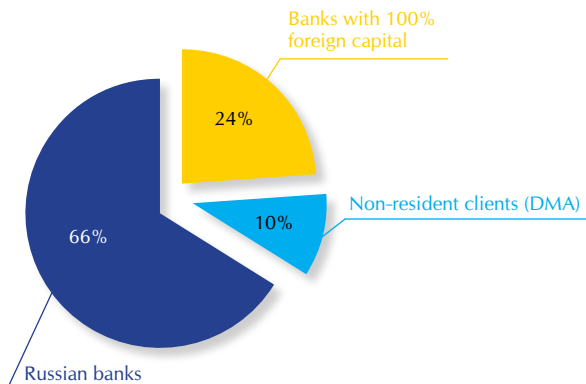


Figure 5.4.
Foreign exchange market turnover by categories of participants/clients 2012 (%)

Until recently only Russian subsidiaries of foreign banks were allowed to trade at the exchange, accounting for 25% of the foreign exchange market. Now non-residents can engage in trading at the Moscow Exchange using DMA.

In 2012 non-resident transactions exceeded 10% of the total turnover of the foreign exchange market (see Figure 5.4). In the first quarter of 2013 a total of 150 non-resident clients from twelve countries, including Kazakhstan, Belarus, Ukraine, Latvia and Estonia, operated at the exchange via DMA. The first non-resident client from EurAsEC (Kazakhstan) joined the exchange in the summer of 2012.

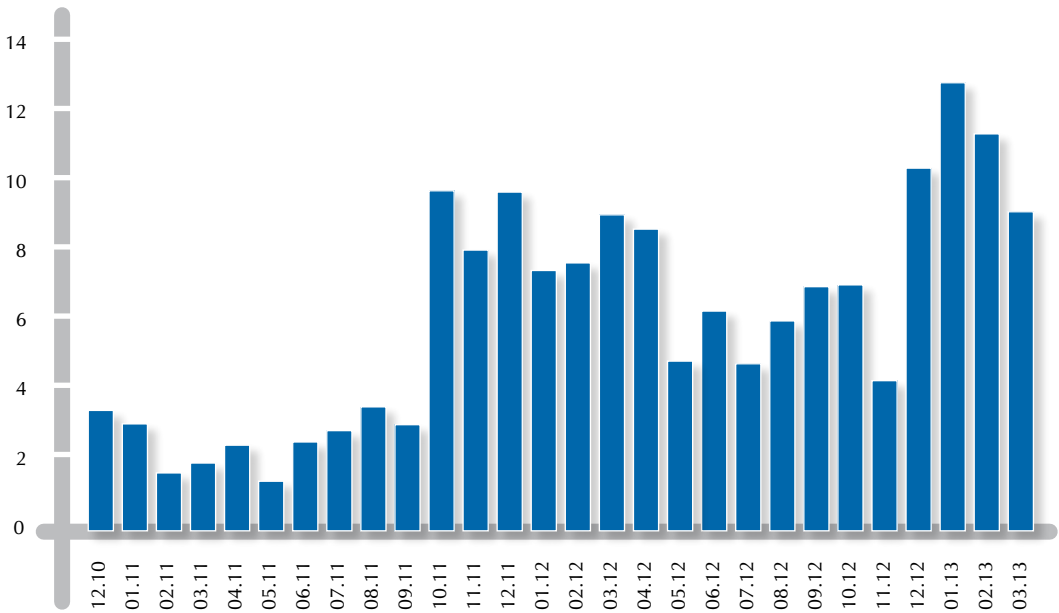
4.3. MORE SETTLEMENTS IN NATIONAL CURRENCIES: THE POSITIVE EXPERIENCE OF LAUNCHING CNY/RUB TRADING AT EXCHANGE

The exchange began to trade the CIS national currencies in the 1990s. Over this period the trade in national currencies at MICEX ranged from very active, with a peak in 1998, to very weak, reducing to almost no trade in 2008-2009.

The relaunching of trading in CIS national currencies requires that primary liquidity exists. This means that CIS banks should be present at the exchange and play the role of market makers for their national currencies. Cooperation is needed with central/national banks from the CIS countries in order to determine reliable settlement banks and potential market makers for the respective currencies.

Figure 5.5.
Average daily trade
in CNY/RUB at the
Moscow Exchange
(CNY million)

The Moscow Exchange has a positive experience in trading national currencies without using the dollar. In late 2010 it began to trade CNY/RUB. Russia and



China are taking joint measures to develop the infrastructure to make mutual settlements in national currencies. In June 2011 the Bank of Russia and the People's Bank of China signed an agreement on making settlements in national currencies. In September 2011 the People's Bank of China permitted Russian participants in the CNY/RUB segment at the Moscow Exchange to open special accounts in China.

This market is growing dynamically: in 2012 CNY trading volumes at the Moscow Exchange grew by more than 70% compared to 2011. About eighty banks took part in transactions, including five banks that operated as market makers (with two Chinese banks among them). In the first quarter of 2013 the volume of trading in CNY increased by 40% year-on-year (see Figure 5.5).

The exchange considers trading in CNY as a promising direction in the development of the financial market. Since April 15, 2013 the Moscow Exchange has been implementing a new project to align the conditions of trading in CNY with those applicable to its leading currency pairs (USD/RUB and EUR/RUB). In particular, it introduced a scheme of the partial deposition of funds and the use of CNY as collateral, as well as new instruments and swap transactions, increased the duration of trading and reduced tariffs. On the day the new terms were made effective seventeen banks took part in trading in CNY and concluded a total of 43 transactions worth CNY 16.5 million (RUB 83.8 million). The first transactions with new instruments and CNY/RUB swap transactions were concluded by the Bank of China (Elos), ICBC (Moscow), My Bank, Levoberezhny Bank and Vostochny Bank (Yarovoi, Mishina, 2013: 43-45).

The development of the CNY/RUB market at the exchange is of significant macroeconomic importance, as it makes it possible to effect settlements under Russian-Chinese contracts in national currencies and helps to strengthen the international role of the rouble.

CONCLUSION

Russia continues to build an up-to-date financial infrastructure in accordance with the world standards, with the aim of creating an international financial centre. In November 2012 the Federal Financial Markets Service assigned the National Settlement Depository (NSD, 99% of which is owned by the Moscow Exchange) the status of a central securities depository. This has become an important milestone in the advancement of the Russian financial market. The provision of the central registrar functions to the central securities depository will allow it to operate in line with the global standards and will significantly reduce the risks to participants. This should considerably enhance non-residents' trust in the Russian market. In the future liquidity increase and reduction of settlement costs are expected, as all market participants will conduct transactions in a single post-trading platform.

The Bank of Russia plans to expand the time of operation of its online express payment system and expects that in a year it will be operationally ready to include the rouble in the list of the CLS (Continuous Linked Settlement) currencies (Interfax, 2012).

The launching of the IFEM, the use of the infrastructure of neighbouring countries by its participants and the availability of direct quotations for national currencies should improve the effectiveness of EurAsEC/CIS financial markets and foster their full integration with the global system. The positive experience of cooperation between CIS exchanges indicates that it is possible to set up a regional financial centre. The components of its infrastructure could be placed in different EurAsEC/CIS countries yet remain united in a single system of exchange trade, clearing and settlements.

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6

Analysis of Trade and Production Linkages between Border Regions of Russia and Kazakhstan: Impact of Customs Union and Single Economic Space

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The present article, based on the corresponding report CU and cross-border cooperation between Kazakhstan and Russia by the Centre for Integration Studies of the Eurasian Development Bank (EDB) and the International Centre

for Social and Economic Research (Leontief Centre) (EDB, 2012a). The complete Russian version of the report contains a full description of the methodology and references¹.

On July 1, 2011, Belarus, Kazakhstan and Russia abolished customs controls at interstate borders within their Customs Union (CU), transferring them to the external borders of the Union, which became the sixth such bloc in the world economy.

The three countries' common customs zone thus began to function in full scale, which created favourable conditions for the development of trade and production ties between border regions in Russia and Kazakhstan. Firstly, this led to a significant simplification of international trade both between Russia and Kazakhstan and between these and other countries. Russian and Kazakh companies got better access to the markets of each other and that of Belarus, as well as to markets outside the CU. Secondly, the transportation time for freight and passengers shortened. Thirdly, new opportunities emerged for the development of multifaceted cooperation ties between Russian and Kazakh companies, which helps establish joint production enterprises and increase the supply of raw materials, components and finished products. Fourthly, favourable conditions were created for the joint operation, modernisation and capacity enhancement of engineering, power supply and transport infrastructures that tie the two countries together. Fifthly, important prerequisites were created for improving the economic climate and the investment attractiveness of the border regions of Russia and Kazakhstan that are viewed as the main ground for deepening the process of integration between the two countries. These prerequisites include, among others, the potentially positive effect of competition between jurisdictions, as the CU makes it possible to choose more favourable conditions for business operations within the common economic area, including better tax conditions.

The purpose of this article is to analyse the effects of the Customs Union on economic interaction and production cooperation between the border regions of the Russian Federation and the Republic of Kazakhstan. The article is based on the results of joint research by the EDB Centre for Integration Studies and the Leontief Centre. The authors also used research done by the Kazakhstan branch of Russia's Institute for Comparative Social Research (CESSI) under a project titled, "The Impact of the Customs Union and the Single Economic Space on the Small and Medium-Sized Business Sector in Kazakhstan's Regions Bordering Russia."

¹ http://www.eabr.org/r/research/centre/projectsCII/KAZ_RUS/

1. TRADE EFFECTS OF ESTABLISHMENT OF CUSTOMS UNION

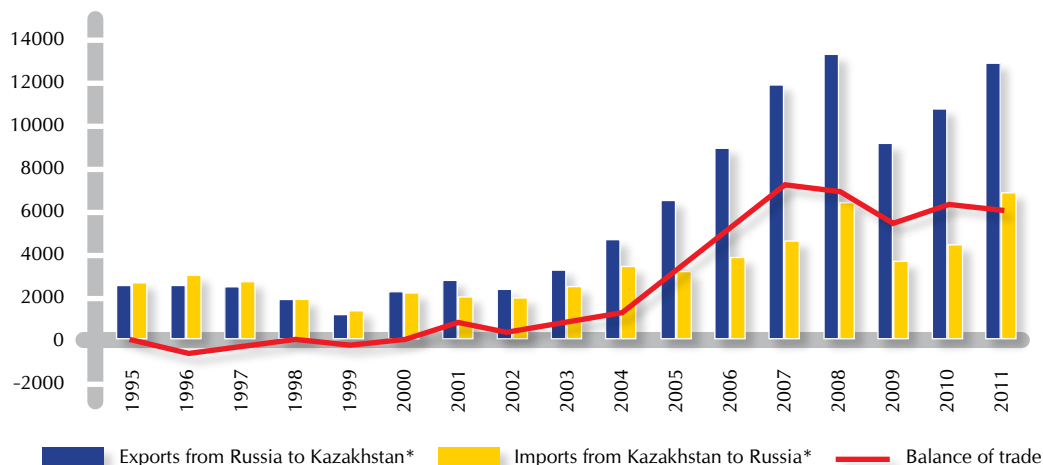
Dynamics of Bilateral Trade between Russia and Kazakhstan

Bilateral trade between Russia and Kazakhstan² has been developing rather dynamically since the late 1990s, when the downturn caused by the 1998 financial crisis started to be overcome. The value of bilateral trade rose at a high rate until 2009. That year was marked by a decline, which, however, was largely due to a fall in dollar prices. The upward trend continued in 2010 and the value of bilateral trade closely approached the record 2008 level in 2011.

Approximately since 2000, a feature of trade between Russia and Kazakhstan has been an export surplus for Russia and a trade deficit for Kazakhstan: the value of Russian exports to Kazakhstan has been steadily higher than the value of imports from Kazakhstan. Moreover, the trade imbalance in favour of Russia, partially due to the scale of its economy, has increased significantly in the last decade. In recent years, the value of Russian exports to Kazakhstan has been more than twice the value of imports from the neighbouring country. In 2011, Russia's export surplus in bilateral trade decreased, but not significantly (see Figure 6.1).

Figure 6.1.
Bilateral trade
between Russia
and Kazakhstan
(\$ million)

Source: Data from
the Federal State
Statistics Service of
Russia



² Owing to the abolition of customs clearance procedures for goods at the Russian-Kazakh border on July 1, 2010, the figures for exports and imports of Russia and Kazakhstan for the second half of 2010 and for 2011 do not include exports and imports in bilateral trade. That is why the data for 2010 and 2011 are not comparable with each other and with data for previous years.

At the same time, despite the growing absolute figures of bilateral trade, relative figures have been rather stable for both countries in the last few years. This is true for the share of exports to Kazakhstan in overall Russian exports, the share of exports to Russia in overall Kazakh exports, the share of Kazakhstan in overall Russian imports and the share of Russia in overall Kazakh imports (see Figure 6.2), which can suggest an increased degree of diversification of foreign trade for both Russia and Kazakhstan.

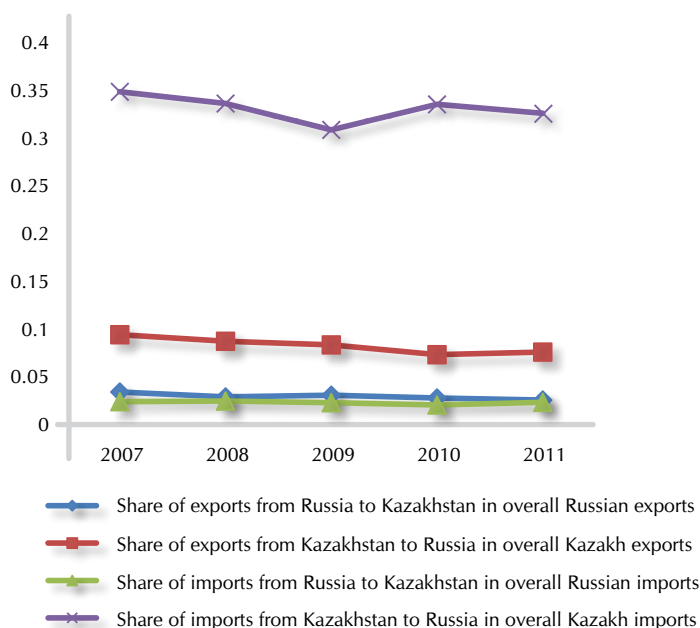


Figure 6.2.
The significance
of bilateral trade
for Russia and
Kazakhstan (%)

Source: Data from
the Federal State
Statistics Service
of Russia and the
Statistics Agency of
Kazakhstan

Table 6.1 shows data about bilateral trade between Russia and Kazakhstan in the first quarter of 2012. It should be noted that data for Russian-Kazakh trade published by the Kazakh finance ministry's Customs Control Committee, Kazakhstan's Statistics Agency and the Federal State Statistics Service of the Russian Federation differ rather significantly, showing different trends.

This is largely due to differences in methods used in customs statistics and balance of payments statistics. In addition, while analysing customs data, one should take into account the fact that the first quarter is usually a down period for bilateral trade between Russia and Kazakhstan – especially in terms of exports – and therefore statistics for Q1 of 2012 are not very impressive and do not precisely reflect the actual state of bilateral trade.

Table 6.1.

**Trade between
Russia and
Kazakhstan in Q1
of 2012 against Q1
of 2011 (\$ million)**

Indicator	January – March 2012	January – March 2011	Growth rates (%)
Kazakh exports to Russia (Russian imports from Kazakhstan)	1525	2137	71.4
Kazakh imports from Russia (Russian exports to Kazakhstan)	3515	3135	112.1
Volume of trade between Russia and Kazakhstan	5040 (4712')	5272 (4425')	95.6 (106.5')

Source: Data from
the Customs Control
Committee of the
Ministry of Finance
of Kazakhstan;

Note: 'Data from
the Federal State
Statistics Service of
Russia

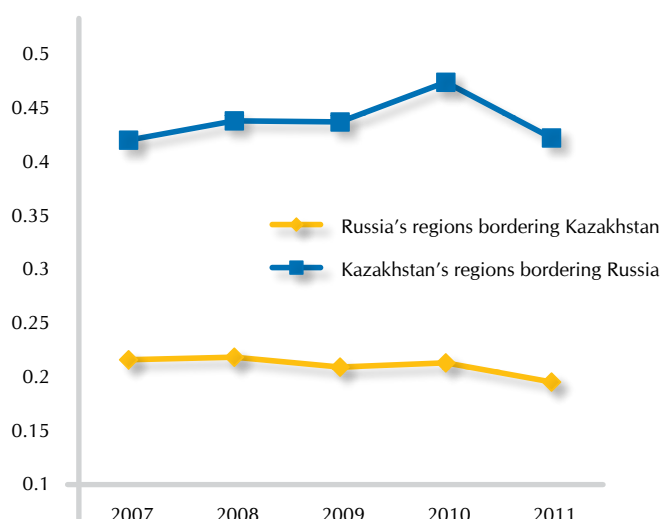
Peculiarities of Foreign Trade of Border Regions of Russia and Kazakhstan

The overall volume of foreign trade of Russia's regions bordering Kazakhstan (Russian border area) is comparable with that of Kazakhstan as a whole in absolute terms. At the same time, although the overall volume of foreign trade of Kazakhstan's regions bordering Russia (Kazakh border area) is predictably lower than that of the Russian border regions, the difference between the volumes of trade of the adjacent regions of the two countries is noticeably smaller than the difference between the overall volumes of foreign trade of Russia and Kazakhstan (see Figure 6.3).

Figure 6.3.

**The volumes of
foreign trade of the
Russian and Kazakh
border areas, as
a percentage of
the overall foreign
trade of Russia and
Kazakhstan**

Source: Data from
the Federal State
Statistics Service of
Russia, the Service's
local offices, the
Statistics Agency
of Kazakhstan, the
Kazakh finance
ministry's Customs
Control Committee



This is due to the fact that the role of the Kazakh regions bordering Russia in the foreign trade of Kazakhstan is noticeably greater than that of the Russian border

regions in Russia's foreign trade. Moreover, while the share of the Russian regions bordering Kazakhstan in Russia's foreign trade has been relatively stable in recent years, fluctuating within a range of 14 to 15% – 12% in 2011 – the respective indicator for Kazakhstan increased from about 40% in 2007 to almost 47% in 2010 – and declined to 41% in 2011 because of changes in the global market for crude oil and mineral resources. For Kazakhstan, its regions bordering Russia are really a sort of window to Russia, the Single Economic Space (SES) and the West, while the role of trade, including transit trade, between the Russian border regions and Kazakhstan in Russia's foreign trade is rather secondary. However, this is due to the fact that the main trading partners of Russia are in the West and not in the South or the East.

The higher focus of the Kazakh border area on foreign trade compared with the Russian border area – as well as that of Kazakhstan as a whole against Russia – can also be seen in the ratio of foreign trade to GDP/GRP. Moreover, the significance of foreign trade is greater for the Kazakh border area than for the country as a whole, while it is smaller for the Russian border area (see Figure 6.4).

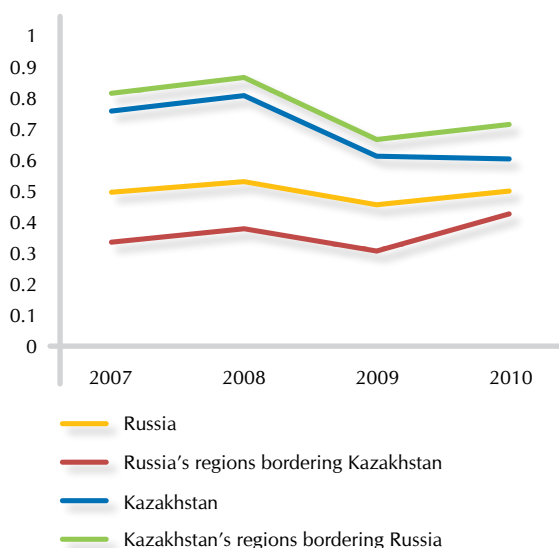


Figure 6.4.
Foreign trade,
in percent of
GDP/GRP of Russia,
Kazakhstan and their
border areas

Source: Data from the Federal State Statistics Service of Russia, the Service's local offices, the Statistics Agency of Kazakhstan, the Kazakh finance ministry's Customs Control Committee

As for the regional structure of exports from the border regions of Russia and Kazakhstan, it should be noted that both the former and the latter have only one key export region – or two, at a stretch, in the case of Kazakhstan. In the Russian border area, it is the Tyumen region, which accounts for more than half of all exports from the border regions. For the Kazakh border area, it is

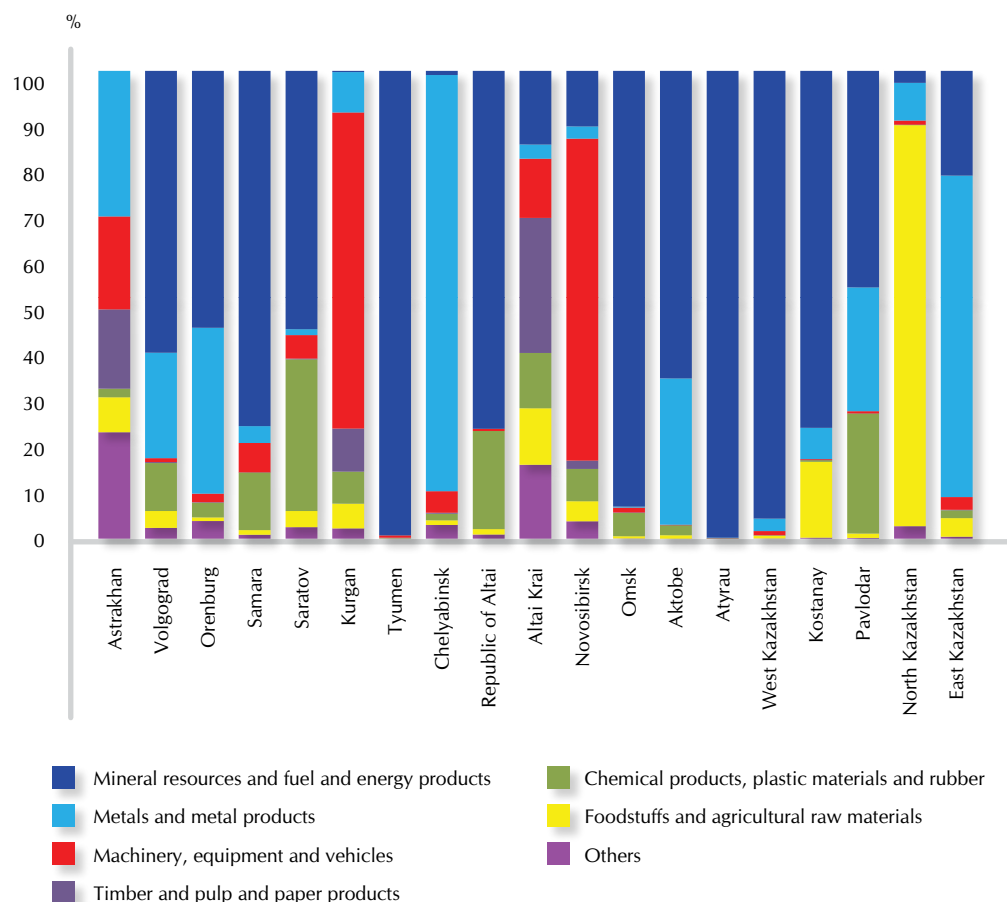
the Atyrau region, which accounts for almost two-thirds of all exports from the border regions and, to a much lesser degree, the Aktope region. The large share of all the three regions in the border area's exports is primarily due to the production and processing of oil, natural gas and other mineral resources and the availability of transport and logistics infrastructure in the regions.

Figure 6.5.
The commodity
structure of exports
by region in 2010
(%)

Source: Data from
the Federal State
Statistics Service
of Russia and the
Statistics Agency of
Kazakhstan

It should also be noted that foreign trade plays a more important role in the economy of the border regions of Kazakhstan than in the economy of the border regions of Russia in terms of foreign-trade-to-GRP ratio.

The border regions of Russia and Kazakhstan have similar structures of exports, which are dominated by mineral resources and fuel and energy products, on the other hand and similar structures of imports on the other hand (see Figures 6.5 and 6.6).



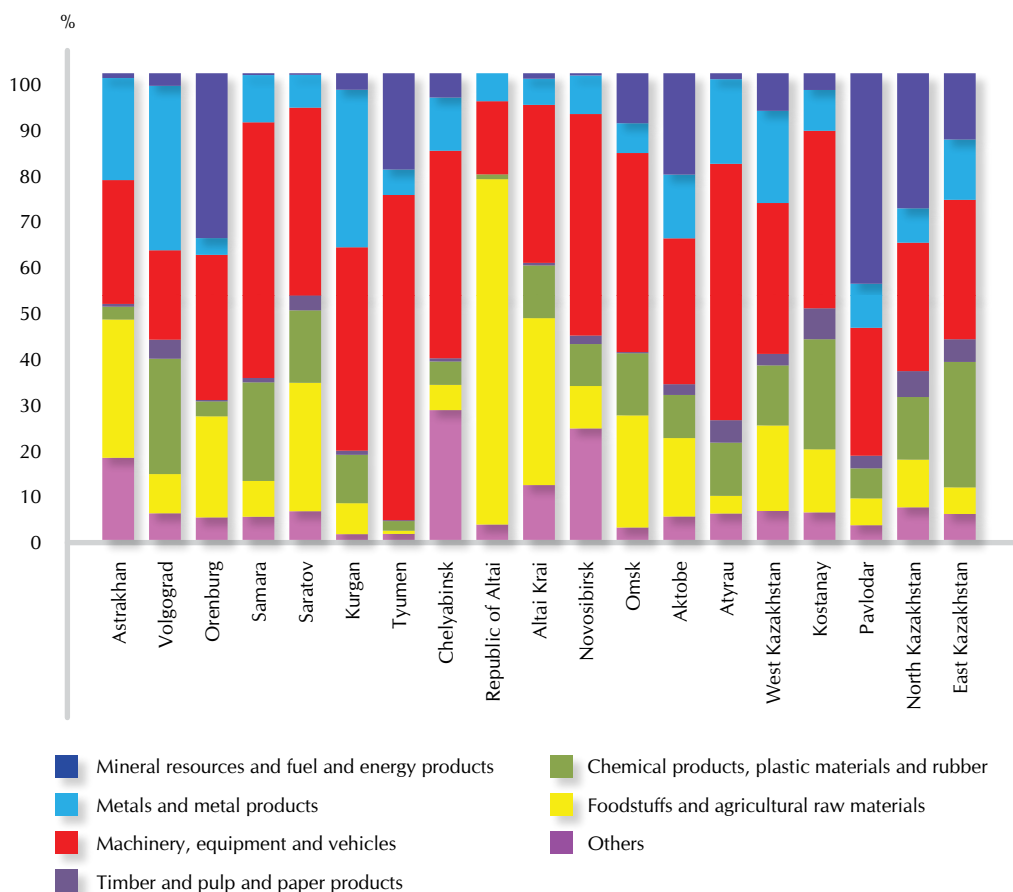


Figure 6.6.
The commodity
structure of imports,
by region in 2010
(%)

Source: Data from
the Federal State
Statistics Service
of Russia and the
Statistics Agency of
Kazakhstan

Functional ties between businesses in the border areas of Russia and Kazakhstan have largely survived since the Soviet era and exist in the fuel and energy sector and the metallurgical industry, which corresponds with the structures of exports and imports of the border regions (see Figure 6.7). If fuel, energy and metallurgical products are not taken into account, exports from the Russian border area are dominated by chemical products, machinery and equipment, and exports from the Kazakh border area are dominated by chemical products and grain.

While evaluating the potential for the development of trade relations between the border areas of Russia and Kazakhstan, one should take into account the following:

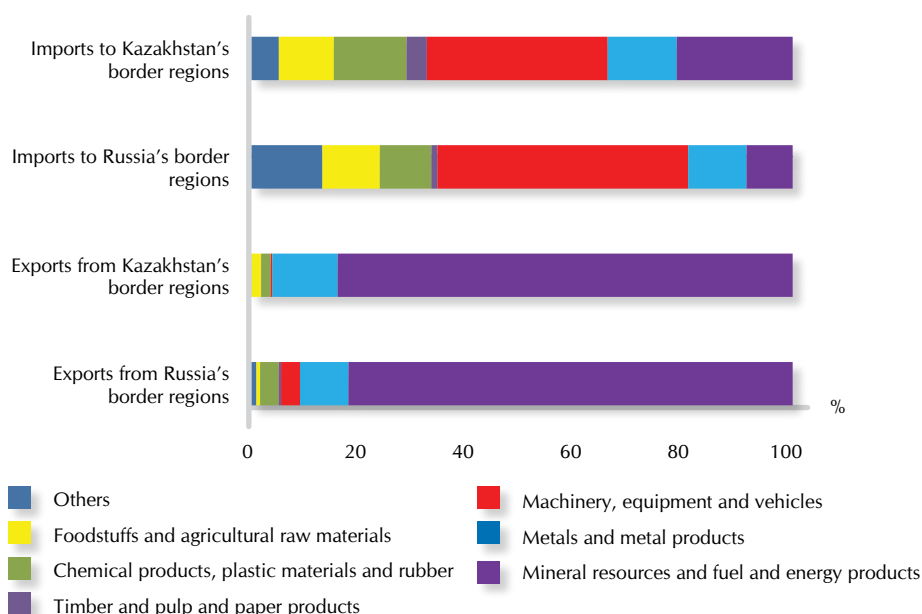


Figure 6.7.

The commodity structure of exports and imports of the border areas of Russia and Kazakhstan in 2010

Source: Data from the Federal State Statistics Service of Russia and the Statistics Agency of Kazakhstan

- Apart from the Kazakh border area, there are other regions in Kazakhstan that are attractive for Russian companies. In particular, those are Almaty and Astana. It is where there is demand for highly processed goods, electronics, household appliances, medicines and cosmetics.
- Small and medium-sized wholesale and retail businesses need a different type of infrastructure, in particular motor roads, crossings and related services. At the same time, large businesses that sell raw materials mainly use railroads and pipelines. Therefore a diversified policy is needed to support businesses on both sides of the lengthy border between the two countries.

2. STRUCTURAL EFFECTS OF ESTABLISHMENT OF CUSTOMS UNION

As a result of the creation of new conditions for business activities and interaction between various types of businesses, there should be structural effects in the two countries, which manifest themselves in the use of labor resources, production and infrastructural cooperation and mutual investment. This section deals with manifestations of these effects in the border areas of Russia and Kazakhstan in the context of the national economies.

Dynamics of Population Growth and Migration Flows

Structural effects manifest themselves in the use of labor resources, in which migration is an indicator. Therefore it is expedient to review in detail migration trends in the two countries and their border areas.

The intensity of migration between the countries has been on the decline. This is characteristic of migration both to and from Russia. Migration from Kazakhstan to Russia has decreased much faster than migration from Russia to Kazakhstan. In particular, in the period between 2000 and 2010, migration from Kazakhstan to Russia decreased 4.1 times, while migration from Russia to Kazakhstan decreased 2.8 times. This led to a significant reduction in the share of migrants from Kazakhstan to Russia in the total number of migrants to Russia, which shrank from 35% in 2000 to 15% in 2010. The share of migrants from Russia to Kazakhstan in the total number of migrants to Kazakhstan, on the contrary, increased from 12% in 2000 to 21% in 2010 (see Figure 6.8).

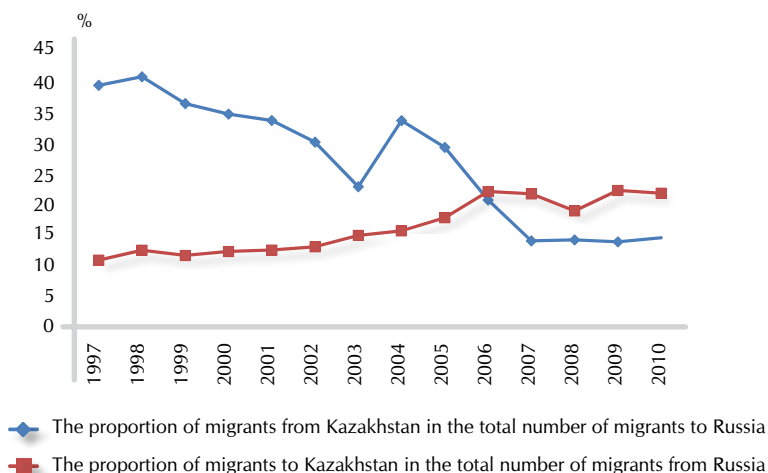


Figure 6.8.
The number of migrants from Kazakhstan to Russia and from Russia to Kazakhstan (in % of the total number of migrants)

Source: Data from the Federal State Statistics Service of Russia

Amid this trend, the intensity of migration between the border areas of Russia and Kazakhstan has remained at the same level. The number of migrants to the Russian border area from Kazakhstan has been much higher than the number of those leaving it. For a long time, the Astrakhan region was an exception to this rule, but in 2011, the number of migrants from Kazakhstan to this region exceeded the number of those leaving for Kazakhstan. In the period between 2007 and 2011, the immigration exceeded emigration by 38%. Moreover, the number of migrants to Kazakhstan from the Russian border area has tended to fall. In particular, their number decreased by 78.2% between 2007 and 2011.

Dynamics of Amount and Structure of Gross Regional Product in Border Regions of Russia and Kazakhstan

The aggregate gross product of the Russian-Kazakh border area is dominated by the production of mineral resources (28%), followed by other sectors (21%), the manufacturing industry (15%), transport, communications and trade (10% each).

The proportion of the gross regional product (GRP) of Kazakhstan's border regions in the aggregate gross product of the Russian-Kazakh border area is significantly smaller than that of the GRP of Russia's border regions.

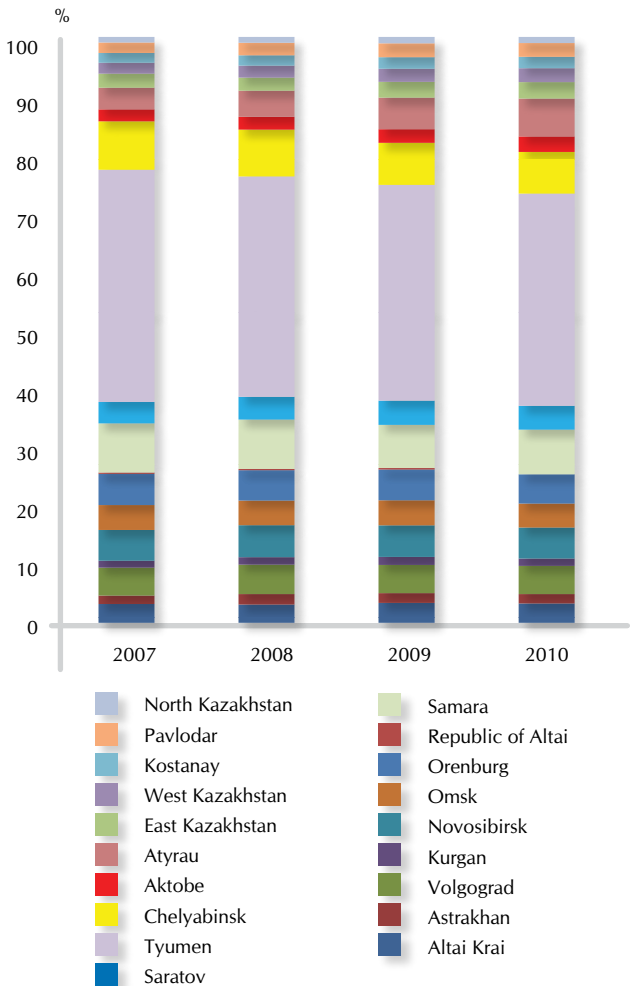


Figure 6.9.
The regional
structure of the
GRP of the border
regions of Russia and
Kazakhstan (%)

Source: Data from
the Federal State
Statistics Service
of Russia and the
Statistics Agency of
Kazakhstan

However, in the period between 2007 and 2010, the share of Kazakhstan's border regions in the aggregate gross product of the border area was steadily growing to reach 20% in 2010.

Owing to the economic crisis, the aggregate gross product of the border area decreased by almost one-fourth in 2009. It should be noted that the GRP of Kazakhstan's border regions decreased less than that of Russia's border regions.

The Tyumen region accounts for more than 30% of the aggregate gross product of the border area, and the Tyumen, Chelyabinsk, Samara, Orenburg, Omsk, Novosibirsk and Atyrau regions account for more than 60% (see Figure 6.9).

The period between 2007 and 2010 saw an increase in the share of the Kazakh border area in Kazakhstan's GDP and a slight decrease in the share of Russia's border regions in the GDP of the Russian Federation.

In particular, the proportion of the GRP of the border regions of Kazakhstan in its GDP increased from 37 to 40%, and the proportion of GRP of the border regions in Russia's GDP decreased from 21 to 20%.

Dynamics of Two-way Investment

In the period between 2000 and 2011, there was a rise in investment from Russia to Kazakhstan and from Kazakhstan to Russia. In particular, during that period, Kazakh investment in the Russian economy increased 427.7-fold, and Russian investment in the Kazakh economy increased 557.8-fold. It is noteworthy

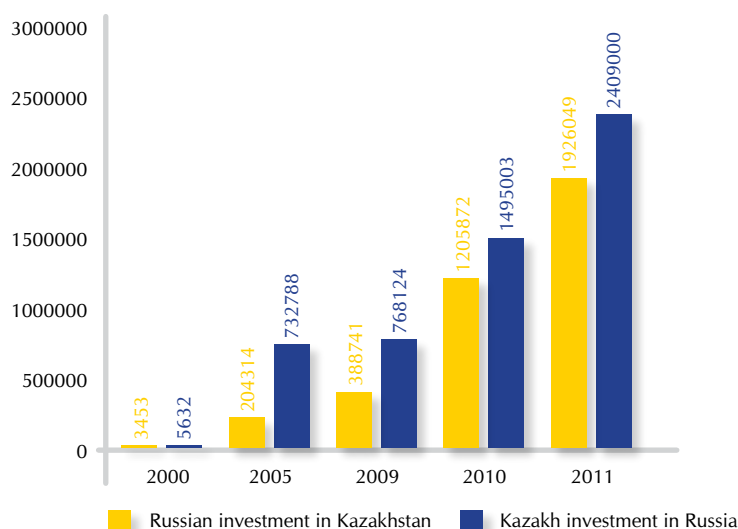


Figure 6.10.
Two-way investment
between Russia
and Kazakhstan
(\$ thousands)

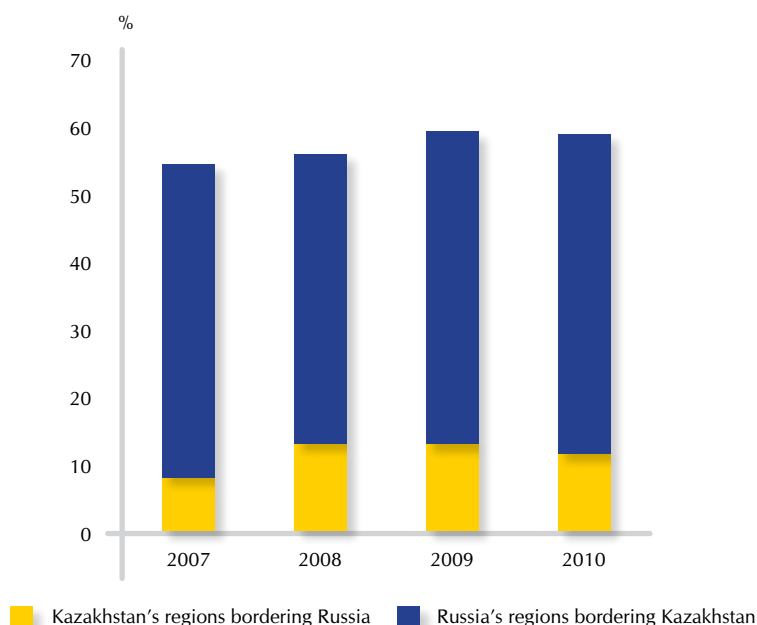
Source: Data from
the Federal State
Statistics Service of
Russia

that Kazakh investment in the Russian economy has always exceeded Russian investment in the Kazakh economy. However, the gap decreased from 63.1% in 2000 to 25.1% in 2011 (see Figure 6.10).

Fixed capital investment by entities involving foreign capital in Russia's border regions was significantly smaller than in other regions of Russia. In the border regions of Kazakhstan, such entities' investment accounted for about 60% of all investment in the national economy (see Figure 6.11).

Figure 6.11.
Fixed capital investment by entities involving foreign capital (the shares of the border areas in the national totals)

Source: Data from the Federal State Statistics Service of Russia and the Statistics Agency of Kazakhstan



In the period between 2007 and 2010, the economy of the Atyrau region was, with about 40%, the absolute leader in terms of investment by entities involving foreign capital among the regions of the Russian-Kazakh border area. The Aktoke region ranked second, followed by the Pavlodar, Kostanay and Chelyabinsk regions. The Tyumen region was at the bottom of the list of the leading border regions in terms of the share of entities involving foreign capital in total investment in the region.

An increase occurred in the proportion of companies operating in Russia's border regions in the total number of companies in Russia that involved Kazakh capital. Their share grew from 30.8% in 2000 to 60.4% in 2010.

3. INSTITUTIONAL EFFECTS OF ESTABLISHMENT OF CUSTOMS UNION

Institutional effects can appear on the basis of conditions and opportunities stemming from the adoption of a number of legal regulations and agreements and the establishment of supranational and intercountry bodies for cooperation.

The effects will be determined by both the activities of these institutions and result in an increase in the competitive capacity of the economies of the CU member countries and the economies of the border regions, the narrowing of the gap between their development indicators, and the implementation of programmes and other budget initiatives for the development of cross-border cooperation. One should distinguish between short-term and long-term effects, with the latter manifesting themselves in economic recovery on both sides of the border and the former in the narrowing of the gap between the indicators of social and economic development. The dynamics of price levels and the dynamics of pay and households' income serve as indicators of the manifestation of institutional effects. It should be noted that data for a longer span of time are needed for an analysis of institutional effects to produce more representative results.

In the border area, the period of an initial equalisation of prices, in particular gasoline prices, currently comes to an end and economic growth is still largely determined by global crisis developments.

Comparative Dynamics of Inflation Rates and Price Levels

In the period between 2007 and 2011, the inflation rates in the border regions of Russia and Kazakhstan tended to be similar (see Figure 6.12).

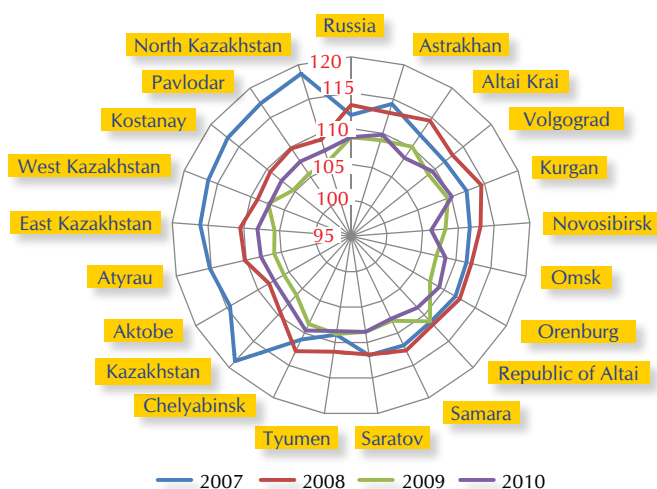


Figure 6.12.
The December-over-December
Consumer Price
Index (%)

Source: Data from
the Federal State
Statistics Service
of Russia and the
Statistics Agency of
Kazakhstan

It may be helpful study changes in the prices of the most socially important goods (electricity, gasoline, beef, flour and milk). We paid particular attention to the changes in electricity and gasoline.

Figure 6.13.
Electricity prices
(in \$ per 100 kWh)

Source: Data from local offices of the Federal State Statistics Service of Russia and the Statistics Agency of Kazakhstan

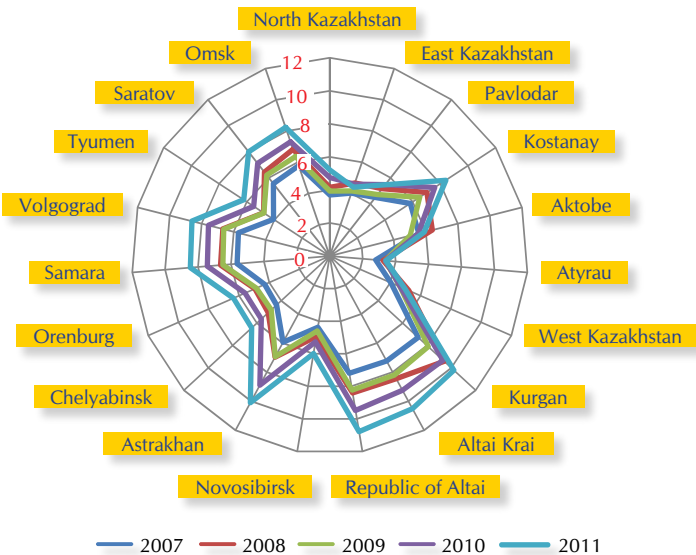
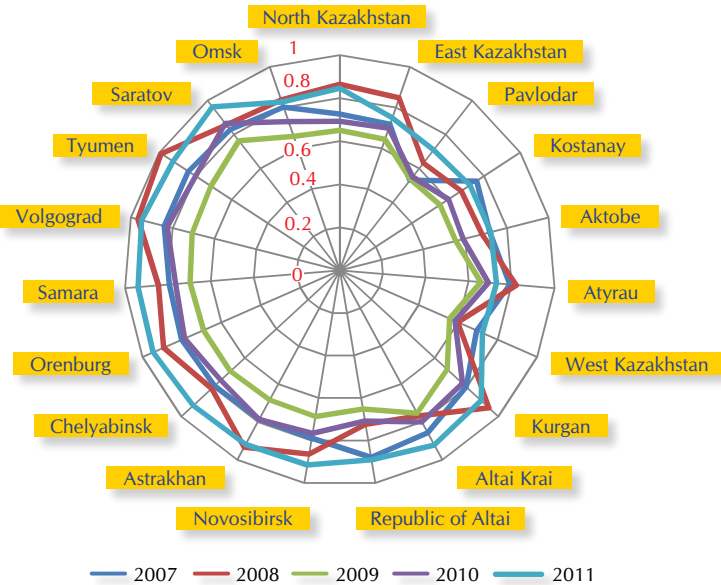


Figure 6.14.
Changes in average
annual prices of
95-octane gasoline
(in \$ per liter)

Source: Data from local offices of the Federal State Statistics Service of Russia and the Statistics Agency of Kazakhstan



In the period under review, electricity prices were on the rise and the difference between electricity prices in the border regions of Russia and Kazakhstan increased as well (see Figure 6.13), while prices of 95-octane gasoline rose in both the Russian and the Kazakh border area, but the difference between them decreased across all the regions (see Figure 6.14).

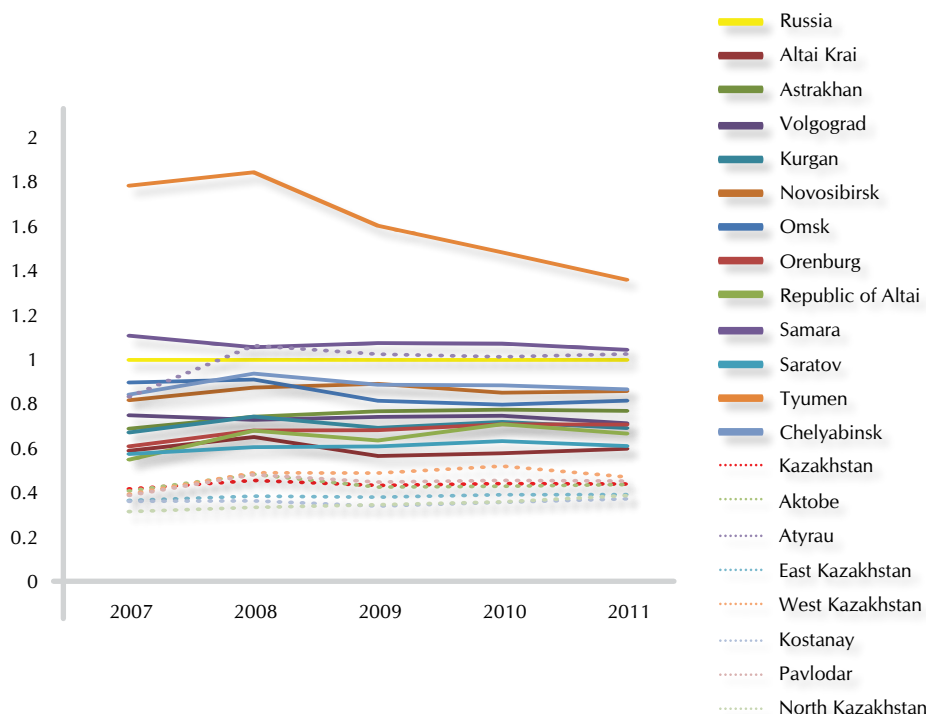
Our analysis found that except for gasoline prices, the levels of prices of most goods in the Russian and Kazakh border regions did not tend to become equal. The difference in prices between the border regions in Russia was higher than between the border regions in Kazakhstan for all goods under review except gasoline.

Comparative Dynamics of Per Capita Money Income

Per capita money income was significantly lower in the Kazakh border regions, except for the Atyrau region, than in the Russian border regions. At the same time per capita money income in the overwhelming majority of the Russian border regions, except for the Tyumen and Chelyabinsk regions, was below the average Russian level (see Figure 6.15).

Figure 6.15.
Per capita money
income (in % of
Russia's average)

Source: Data from
the Federal State
Statistics Service
of Russia and the
Statistics Agency of
Kazakhstan



Average money income in Atyrau region exceeded not only that in the other Kazakh border regions but also the average Russian per capita money income.

A comparison of income and wages in the border regions of Russia and Kazakhstan, except the Atyrau region, leads to the conclusion that the gap between the levels of income is much wider than the gap between the levels of pay.

4. TESTING OF HYPOTHESIS OF EXISTENCE OF FUNCTIONAL MACROREGION IN RUSSIAN-KAZAKH BORDER AREA

As far back as the beginning of the 20th century, economists began to study linkages between spatial concentrations of economic activity on the one hand and the development of production, technological, transport, logistical and other ties between firms on the other hand, perceiving these two processes as interdependent. This idea can be found in papers by, among others, Alfred Marshall (1920), Walter Christaller (1933), Bertil Ohlin (1933) and Edgar Hoover (1948). Papers on the new economic geography, in particular those by Paul Krugman (1991), Anthony Venables (Krugman, Venables, 1996) and others, point to the dependence of efficiency on the scale of production (in the case of a regional concentration of production), the existence of common infrastructure and resources (including labor resources), proximity to the consumer market and the size of the market, a preference for diversity in consumption (including intermediate consumption), technological external effects and “face-to-face” contacts as factors contributing to the geographical concentration of production. These are the factors that can be viewed as the basis for those functional inter-regional linkages that make it possible to describe one border region or another as functional.

Given the above, it is justified to test a hypothesis of the existence of established functional linkages in the border area on the basis of determining whether or not there is a geographical concentration of economic activity because geographical concentration is connected with such linkages from the standpoint of economic and geographical models.

One can speak about the existence of a functional macroregion if there is a considerable concentration (agglomeration) of economic activity, because in this case, linkages between its individual constituent regions are either substantial relative to the scale of their economies or determined by geographical proximity.

The concept of a functional macroregion implies the existence of functional linkages between regions because of their proximity or adjacency, or else this concept loses any meaning. That is why we propose analysing the large border area of Russia and Kazakhstan from the standpoint of the phenomenon of the

concentration of economic activity around the core/cores of the macroregion in question.

The postulated lack of a one-direction causal relationship (or rather the lack of theoretical or practical substantiation of such a relationship precludes the possibility of using a regression analysis to explore interdependence between the macroeconomic indicators of neighbouring regions as a tool of statistical (econometric) analysis for testing the above-stated hypothesis.

In addition, even if we assume the causal dependence of variables have one direction or another, it is impossible to use regression-analysis methods because of the shortage of observations for a cross data analysis with regard to data for the 19 (7 + 12) regions in a given period of time to draw statistically representative and substantiated conclusions.

An analysis of panel data (i.e. data for the 19 (7 + 12) regions for several periods of time) or a time-series analysis (i.e. data for a given region for several periods of time) seem to be unfounded in our case because of, apart from the lack of substantiation for the assumption on the direction of the causal relationship, the processes of the geographical concentration (agglomeration) of economic activity are long-term processes that take decades, if not centuries, as they are based on the concentration of human resources, physical capital and infrastructure in certain areas.

Comparable macroeconomic data for regions of Russia and Kazakhstan are only available for the first years after the collapse of the USSR. It is undisputable that the existing transport and other infrastructure, the current pattern of population distribution and the geographical distribution of productive forces in Russia and Kazakhstan were established in the Soviet era and have not undergone a significant change in recent years.

Since the available time series are relatively short, it is impossible to use the Granger causality test to substantiate the assumption of a causal relationship in one direction or the other.

Owing to the above, it seems that correlation analysis – to determine whether or not there are statistically significant relationships between variables – will be an optimal tool to test the hypothesis in question, as it does not imply any functional dependence between variables.

It should be noted that papers on the quantitative study of the concentration (agglomeration) of economic activity in a region (country) usually assess the degree of concentration in the region (country) as a whole. The nature of the subject of this statistical analysis is fundamentally different and there is, as far as we know, no analogue of it in the existing literature. It is aimed at finding out whether or not there is a concentration of economic activity around the core/cores of the macroregion in question. To assess the correlation between

the GRPs of individual regions in the Russian-Kazakh border area and the aggregate GRP of neighbouring regions, we use Spearman's rank correlation coefficient.

In our case, the use of this coefficient (instead of, for instance, the Pearson correlation coefficient) is justified by the following considerations: firstly, there are a limited number of observations (because of the small number of regions), which are not enough to ensure the statistical significance of conclusions from the calculation of the Pearson coefficient, but are sufficient if Spearman's coefficient is used, and secondly, there are a large spread of values and the different sizes of the GRP of an individual region on the one hand and the aggregate GRP of the neighbouring regions on the other, which is neutralised in case of using Spearman's coefficient, which is calculated with the use of ranks, not the absolute values of correlated variables.

Input data for the calculation of Spearman's coefficient include the amount of GRP in 2010 (the latest available data at the time of analysis) for 12 Russian and seven Kazakh border regions and the amount of GRP of the adjacent regions in Russia (17 regions) and Kazakhstan (five regions).

These data are used to calculate Spearman's rank correlation coefficient for the following pairs of variables:

1. The GRP of one of the 19 regions of the Russian-Kazakh border area and the aggregate GRP of all adjacent regions regardless of the country;
2. The GRP of one of the 19 regions of the Russian-Kazakh border area and the aggregate GRP of all adjacent regions in Russia;
3. The GRP of one of the 19 regions of the Russian-Kazakh border area and the aggregate GRP of all adjacent regions in Kazakhstan;
4. The GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions regardless of the country;
5. The GRP of one of the seven Kazakh regions bordering Russia and the aggregate GRP of all adjacent regions regardless of the country;
6. The GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions in Kazakhstan;
7. The GRP of one of the seven Kazakh regions bordering Russia and the aggregate GRP of all adjacent regions in Russia;
8. The GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions in Russia;
9. The GRP of one of the seven Kazakh regions bordering Russia and the aggregate GRP of all adjacent regions in Kazakhstan.

The obtained results of the correlation analysis are shown in *Table 6.2*.

Pair of variables	Number of pairs of values	Value of Spearman's rank correlation coefficient	Value of Student's t-criterion	Critical value of Student's t-criterion for $R \leq 0.05$	Critical value of Student's t-criterion for $R \leq 0.10$	Critical value of Student's t-criterion for $R \leq 0.20$	Conclusion on the statistical significance of the obtained correlation coefficient
The GRP of one of the 19 regions of the Russian-Kazakh border area and the aggregate GRP of all adjacent regions regardless of the country	19	0.065	0.268	2.1	1.74	1.333	no
The GRP of one of the 19 regions of the Russian-Kazakh border area and the aggregate GRP of all adjacent regions in Russia	19	0.174	0.727	2.1	1.74	1.333	no
The GRP of one of the 19 regions of the Russian-Kazakh border area and the aggregate GRP of all adjacent regions in Kazakhstan	19	- 0.541	2.654	2.1	1.74	1.333	negative correlation for $R \leq 0.05$
The GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions regardless of the country	12	0.364	1.234	2.228	1.812	1.372	no
The GRP of one of the seven Kazakh regions bordering Russia and the aggregate GRP of all adjacent regions regardless of the country	7	- 0.714	2.282	2.57	2.015	1.476	negative correlation for $R \leq 0.1$
The GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions in Kazakhstan	12	- 0.655	2.74	2.228	1.812	1.372	negative correlation for $R \leq 0.05$
The GRP of one of the seven Kazakh regions bordering Russia and the aggregate GRP of all adjacent regions in Russia	7	- 0.893	4.433	2.57	2.015	1.476	negative correlation for $R \leq 0.05$
The GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions in Russia	12	0.405	1.403	2.228	1.812	1.372	positive correlation for $R \leq 0.2$
The GRP of one of the seven Kazakh regions bordering Russia and the aggregate GRP of all adjacent regions in Kazakhstan	7	0	0	2.57	2.015	1.4759	no

Table 6.2.
Results of the
correlation analysis

As can be seen from the correlation analysis results for the time period in question, there is no positive statistically significant correlation between the level of the GRP of an individual region and the aggregate GRP of a sample of contiguous regions. This means that it is premature to assume the existence of a functional macroregion in the Russian-Kazakh border area because the geographical proximity of these regions is not accompanied by a geographical concentration (agglomeration) of economic activity around the key regions inside the macroregion, which is especially true for the Kazakh border area. The only pair with statistically significant – but with an error probability of up to 20% – positive correlation is “the GRP of one of the 12 Russian regions bordering Kazakhstan and the aggregate GRP of all adjacent regions in Russia.” This may suggest that a concentration (agglomeration) of economic activity around key centres really exists on the Russian side of the border, but in the time period in question, it involves only Russian regions (12 border regions plus 17 adjacent Russian regions).

Nonetheless, the recently announced and already launched AvtoVAZ-Asia Auto projects³ and also EURAS projects are a real basis for establishing functional linkages between the economies of the border regions of Russia and Kazakhstan in the manufacturing sector.

CONCLUSION

The initial stage of the existence of the Customs Union has showed positive changes in the volume of external economic activities of Russia and Kazakhstan, but significant trade and structural effects in the border area of Russia and Kazakhstan have not yet manifested themselves in full force.

This is due to:

- a) the short period of observation of these effects;
- b) the trade and production linkages and commodity flows that exist in the border area;
- c) the homogeneity of the economies of the border regions and the long distances between them, coupled with the low degree of connectivity and development of the transport network in the border regions.

³ http://www.lada-auto.ru/cgi-bin/pr.pl?id=0&id_article=93423&prev=1

On September 19, 2012, within the framework of the 9th Russian-Kazakh InterRegional Cooperation Forum in Pavlodar, Kazakhstan, Russia's AvtoVAZ and Kazakhstan's Asia Auto discussed the implementation of a joint project to set up an integrated automobile plant in Kazakhstan with an annual capacity of up to 120,000 cars. The sides agreed that facilities for assembling cars and manufacturing automobile components with a capacity of up to 60,000 units per year would be created at Asia Auto by 2014. The range of models assembled at the plant would include Lada Granta and Lada Kalina-facelift. The sides are also considering the possibility of assembling other models of AvtoVAZ, Renault and Nissan on a semi-knocked-down basis. At the second stage of the project, the output capacity of the plant would be increased to 120,000 cars per year. Kazakhstan, the Siberian and the Far Eastern Federal District of Russia, and the Central Asian and TransCaucasian countries have been identified as markets for the plant's products.

Companies based in the border regions of Russia and Kazakhstan are mainly engaged in trade with third countries and not with each other – especially with regard to exports – except for the supply of Russian oil to Kazakh refineries and Kazakh oil to Russian refineries. Economically, Russia is the predominant player in the CU, and the common market and the common customs zone cannot fundamentally change the competitive environment for businesses in the emerging Single Economic Space within a short period of time.

In addition, it should be noted that the formal degree of liberalisation of trade and economic cooperation was already rather high before the establishment of the CU. Therefore, in the short run, one should not expect any radical change in the accessibility of each other's markets for the SES member countries.

That is why in order to further deepen cooperation between Russia and Kazakhstan, it is necessary to step up cross-border cooperation and pursue a proactive policy aimed at the integration of the border regions at all levels of governance, including the Eurasian Economic Commission, the governments of the two countries, and the regional and municipal authorities, as well as on the part of the business community.

Apart from this, one cannot but agree with Evgeny Vinokurov and Alexander Libman (2012) that on the path to establishing Eurasian regions, there is an obstacle that prevents the integration potential from being realised in full.

Regions, including border ones, are able to overcome barriers to international integration only if they have enough autonomy. Unfortunately, in the post-Soviet area, the political and economic autonomy of regions and municipalities is diminishing. In Russia, this manifested itself in a gradual redistribution of tax revenues towards the federal government and the abolition of direct elections for governor and the removal of the most influential regional leaders from power – a process that ended in 2010 – but a new political cycle that began after parliamentary and presidential elections has already brought a number of changes. In Kazakhstan, the central government initiated an administrative reform with a view to strengthen its power, which in particular envisaged changing the borders of regions. In post-Soviet countries, regional and municipal initiatives are thoroughly monitored and controlled by the central government. As a result, sub-national cooperation actually becomes one of the "branches" of the government's foreign policy, which, as mentioned above, experiences serious problems from the standpoint of cooperation in Northern and Central Eurasia. In addition, in the event of contradictions between the interests of the centre and the interests of regions, the former usually prevail over the latter. Meanwhile, in the European Union, there are both full-fledged federations (for instance, Germany) and countries with strong regional governments (for instance, Spain and Britain) and countries with rather independent municipalities (for instance, Scandinavian countries). Even traditionally centralised France has experienced significant devolution in recent years.

Nonetheless, the development of sub-national cooperation in Eurasia remains a promising avenue. There has lately been a lot of discussion of the idea of establishing an “Asiaregio” similar to the Euroregions in, for instance, Central Asia. The optimistic scenario assumes that “Asiaregios,” along with Euroregions and similar entities comprising both European and Asian areas along the borders of Russia, Kazakhstan and Turkey, for example, could become a strong vehicle for developing Eurasian continental integration.

Of particular importance in this regard is the implementation of the expansive concept of Eurasian regions whose development will be based on integration processes in Eurasia, in the first instance in the SES.

To strengthen trade ties and production cooperation between the border regions of Russia and Kazakhstan, it is advisable to do the following:

1. General economic recommendations:

- Remove the existing restrictions on access to national markets and carry out a gradual and balanced liberalisation of the foreign exchange and financial policies of the SES member countries;
- Coordinate and reconcile macroeconomic, tax, monetary, trade and customs tariff policies;
- Harmonize the national regimes of the CU member countries through making them uniform or through establishing binding standards by SES agreements and supranational regulators;
- Create common transport, power and information systems for closer cooperation between manufacturers in the SES member countries;
- Reduce administrative barriers in the natural monopoly sectors, including with regard the provision of services and access to infrastructure, in particular Russia’s infrastructure (pipelines and railroads);
- Develop uniform principles and rules for competition in the SES, including agreements on uniform principles and rules of competition, on uniform rules for industrial subsidies, on state support of agriculture, and on government procurement.

2. Recommendations for creating conditions for the development of functional regions:

- Create conditions for investment that would help increase the degree of raw material processing (extend added-value chains, especially in Kazakhstan) and transmit growth impulses from the mineral resources sector and the initial processing sector to the manufacturing and services sectors to give an impetus to the development of functional regions in the Russian-Kazakh border area;

- Promote the decentralisation of decision-making for the development of functional regions;
- Coordinate investment to the implementation of infrastructure projects, which can significantly increase the effects of investment; establish a Structural Fund within the framework of the Eurasian Economic Community to carry out infrastructure projects under the aegis of the Eurasian Economic Commission; consider the idea of involving other countries of the region in the SES Structural Fund, primarily countries that are candidates for SES membership. Selection criteria should include an assessment of the potential environmental impact of the project;
- Pay more attention to projects aimed at increasing transport capacity and efficiency in the border areas and developing the local road infrastructure for the purpose of promoting the social and economic development of neighbouring regions. Of particular interest are the standards and practices applied in certain Euroregions to protect water resources;
- Develop requirements for the selection of projects, the co-financing of projects by regional and municipal authorities, the openness and transparency of decision-making procedures;
- Ensure the decentralisation of proposals submitted to the Structural Fund on the part of regional and municipal authorities in neighbouring countries, and the coordination of their policies and social and economic development programmes.

3. Recommendations for improving the statistical base:

- Ensure the proper quality and amount of statistical data. Accurate and relevant information is needed to analyse and assess trade and production linkages in the Russian-Kazakh border area and make decisions on their regulation. Researchers studying integration processes currently experience information problems. All this significantly complicates the analysis of processes taking place in the Russian-Kazakh border area, and therefore affects the quality of administrative decision-making. In this regard it is necessary to improve the quality and amount of statistical data about trade, production and migration linkages between the border regions of Russia and Kazakhstan.

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Integration Sentiment in Post-Soviet Countries: Status and Dynamics

7

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This article provides an overview of the key results of the second wave of the EDB Integration Barometer study implemented jointly by the EDB Integration Studies Centre and the Eurasian Monitor International Research Agency¹. The article contains an analysis of the integration preferences of the citizens

¹ The full version of the EDB Integration Barometer 2013 report with annexes and other supplementary materials on which this article is based are all available at the EDB's website <http://www.eabr.org/r/research/centre/projectsCII/>

of CIS states and Georgia, particularly in the context of their attitude towards the Customs Union (CU) and the Single Economic Space between Russia, Kazakhstan and Belarus (SES), and an assessment of the foreign policy, foreign trade and sociocultural stance of the population of these countries in 2013 in comparison with 2012.

The integration processes in the former Soviet states have been the focus of attention of various interested groups since the very moment of disintegration of the Soviet Union. Politicians talk about integration; business circles call for integration; political scientists, economists, sociologists and other professionals study integration (see, for example, Bolshakov (2012), Vertinskaya (2013), Vinokurov et al., (2009), Spartak (2011), Strategy 2020 (2011a), Yastremsky (2012). In some cases, this interest is strong enough to eventually lead to institutionalisation of integration processes, especially in the economic and international security spheres. For example, in the post-Soviet space, the existence of the Collective Security Treaty Organisation, the Eurasian Economic Community, the Customs Union, the Single Economic Space, and the CIS Free Trade Zone points to a codification of integration processes.

However, integration has other facets besides the economic, military or political. “Top-down” integration in the form of various political alliances or intergovernmental agreements cannot be efficient unless based on support from the “bottom”, i.e. the general population’s integration preferences (orientation) and assessment of the processes which take place at the top level. Moreover, certain aspects of integration cannot be formalised or institutionalised at all, since they belong to the sphere of intercultural interaction and can only be expressed in a population’s opinions and assessments.

Whereas economic ties or political interaction can easily be reflected in statistics, analytical reports and official documents (see, for example, Zadorin (2008a), Zadorin (2008b), the humanitarian measurement of integration in the post-Soviet space reflected in public sentiment and activities until recently has had no reliable and permanent tool for identifying and recording. A few occasional studies, albeit informative, used methodologies that were unsuitable for their purpose, hence the impossibility of measuring the dynamics of integration sentiment or forecasting public reaction to certain foreign policy decisions.

The EDB Integration Barometer project was launched in 2012 to fill these information gaps. Under the project, a methodology and tools were developed for annual opinion polls with a focus on the assessment of foreign policy, foreign trade, sociocultural and other integration preferences of the citizens of the post-Soviet space.

The general objectives of the study are to monitor integration preferences of the population of the post-Soviet space (citizens of CIS countries and Georgia) and to assess the degree of “humanitarian integration” of this space, as expressed by

the foreign policy, foreign trade and sociocultural orientation of the population. The project studies public attitude towards particular aspects and forms of interstate integration activities. In so doing, both economic and political aspects of integration and their humanitarian measurement at the level of social contacts or cultural consumption are taken into account. The results of the study allow the real preferences of the former USSR population to be identified in connection with different facets of integration.

In April-June 2012, the first wave of the study under the EDB Integration Barometer project was carried out (see Zadorin, Moysov, Glod (2012), EDB Integration Studies Centre (2012), and the second wave was completed in March-May 2013. In this paper the authors attempt to present the key results of the second wave and describe the dynamics of integration preferences.

METHODOLOGY

The EDB Integration Barometer study is based on regular monitoring of public opinion using compatible methodologies (and a consistent approach towards selection of the tools to use and to sampling). This allows not only the current status of the population's integration preferences to be recorded, but also how they change over time.

The study's concept is based on the assumption that, the more frequently people from prefer another country of the same region in connection with certain sociocultural, economic or political circumstances, the deeper humanitarian integration is, and the greater potential for public support of real political and economic cooperation the region has. In other words, the fact that the citizens of post-Soviet countries are increasingly inclined to choose from among the other countries of the region rather than from any other parts of the world in their everyday decisions (consumer behaviour, employment, education, tourism, cultural needs, etc.) indicates that the humanitarian integration of the former Soviet countries has a positive dynamic and positive prospects. And, vice versa, preference for other parts of the world in real or hypothetical circumstances indicates the population's orientation towards other geopolitical centres of gravity.

The main methodological problem of the study is that, typically, the issues of international cooperation and integration are not topical to an ordinary citizen, and respondents' preferences for particular countries with which their own country should cooperate or integrate are often based solely on their limited experience of interaction with the respective countries or peoples, or their personal sympathy or interest. Therefore, the term "integration preferences" of an individual is interpreted by the authors as the simpler, generic term "inclination towards a country". This concept, "inclination", at an individual level embraces interest, sympathy, the existence of a connection (through employment, relatives, etc.), and readiness to interact, while at the level of

a country's population it reflects the incidence of the respective directions of inclination towards other countries, i.e. implied popular support of cooperation and integration expressed in the overall public sentiment.

The concept of "inclination" is largely the same as sociocultural distance, but with a positive rather than negative value. A degree of inclination towards a particular country expressed as the frequency of selecting that country for various purposes (tourism, employment, education, source of investments, military and political support, etc.) characterises the respondent population's closeness to the selected country.

To provide a deeper insight into the subject of this study, inclination towards a country was measured on three scales: sociocultural, economic and political. Each of these aspects can in turn be examined by identifying respondents' specific interests using corresponding questions.

The basic method of measuring the integration preferences of the population under the EDB Integration Barometer is a mass survey of adults (over 18 years) from 12 post-Soviet countries using national representative samples. Such surveys are based on a system of periodic international Eurasian Monitor polls (active since 2004, see Zadorin (2010)). The second wave of the EDB Integration Barometer study was conducted within the framework of the 19th round of Eurasian Monitor polls.

In 2012, 11 countries participated in the project (ten CIS countries and Georgia), and Turkmenistan joined in 2013.

Data collection in the form of interviews based on a formal questionnaire was conducted in CIS countries from April 10 to May 28, 2013. The ZIRCON Research Group (Centre of Intellectual Resources and Cooperation in Social Sciences, Moscow, Russia) prepared the questionnaires, processed the data and prepared reporting documents. A total of 14,254 questionnaires were processed. Thus, in 2013 over 14,000 people were polled (from 1,000 to 2,000 in each country of the region).

The main thematic block contained questions all of the same type: respondents were asked to choose from among 25 listed countries in accordance with certain criteria (friendly/hostile, interesting/not interesting, etc.), i.e. a dichotomised scale was used to record the results. The methodology of the study is described in more detail in the full version of the report available on the EDB's website.

The list of answer options allowed three groups of conclusions to be formed on each topic: integration preferences within the post-Soviet space (selection of countries from among the former Soviet republics); integration inclination towards other parts of the world (selection of countries other than the former Soviet republics); and a degree of isolationist sentiment (refusal to name "attractive" countries). Notably, integration inclination towards other parts of

the world has two vectors: inclination towards EU countries and the rest of the world ("other countries").

THE DIRECTIONS OF GEOPOLITICAL INCLINATION

The results of the second wave of the Integration Barometer project allow important conclusions and generalisations to be made on the current status and dynamics of integration preferences (sentiment) in the post-Soviet space².

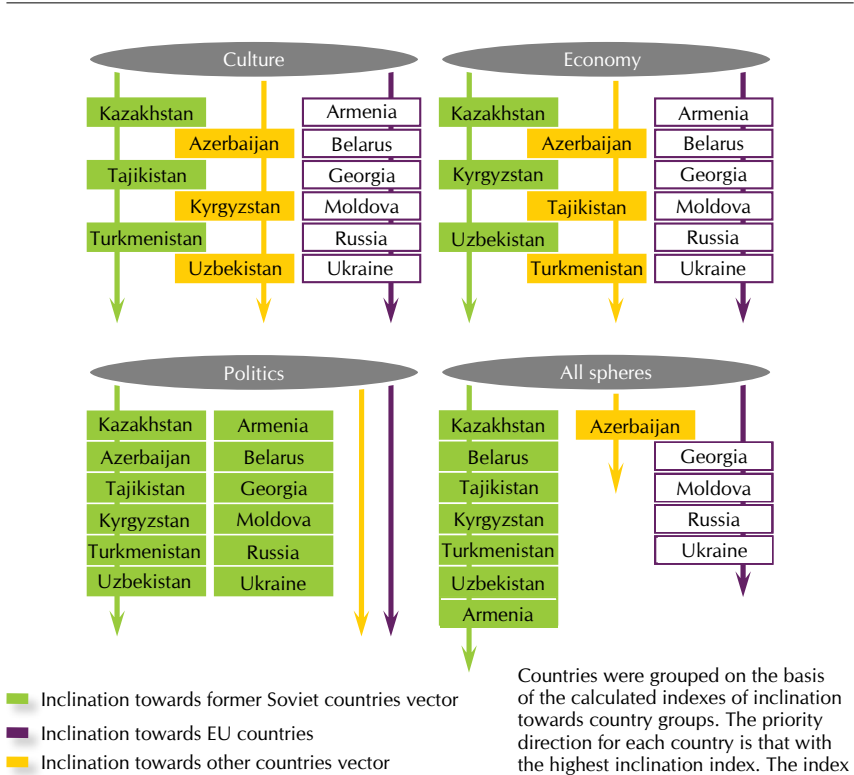
On the whole, the second wave of polls in CIS countries and Georgia ascertained the dominating integration preferences (inclination) of the citizens of those countries and the positions of each country in the overall structure. If we divide all integration preferences into four classes: 1) towards other post-Soviet countries, 2) towards EU countries, 3) towards "other countries", and 4) anti-integration (isolationist) preferences, we can see that all these preferences are present in all the twelve studies countries, albeit not to varying extents. In Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan), and in Armenia and Belarus, inclination towards post-Soviet countries (predominately Russia) prevails.

In Russia, Georgia, Moldova and Ukraine, integration with the EU is often given preference (in Georgia there is equally strong inclination towards the USA, and in Moldova towards Russia). The most common preference in Azerbaijan is "other countries" (Turkey foremost). Finally, Russia, Ukraine and, in some matters, Armenia, Kazakhstan, Turkmenistan and Uzbekistan demonstrate strong isolationist sentiment ("no inclination towards any country").

Therefore, we can conclude that the greatest potential for support of post-Soviet integration exists in those countries which have already joined the Customs Union and the Collective Security Treaty Organisation. Azerbaijan and Georgia have effectively withdrawn from the post-Soviet space. Moldova, Ukraine and, to a lesser extent, Uzbekistan, demonstrate multidirectional integration sentiment. Whereas Russia is a centre of gravity to many other post-Soviet states, its population shows little interest in integration, and is even inclined to isolationist views. This is a source of problems in gaining sociocultural support for integration in the post-Soviet space.

Taking into consideration the three factors of economy, politics and culture, the priority integration direction for most countries is the post-Soviet space (see Figure 7.1), and the key grouping factor is politics. In 2013, citizens of seven countries preferred integration with other post-Soviet countries. The same situation was observed in 2012, except that by the second wave's results, Moldova had shifted to the EU inclination zone, and Turkmenistan took its place in the CIS inclination zone after joining the project.

² The contents of this paper do not necessarily reflect the position of the Eurasian Development Bank.



Countries were grouped on the basis of the calculated indexes of inclination towards country groups. The priority direction for each country is that with the highest inclination index. The index calculation procedure is described in the analytical report (see subsection 4.1, Index calculation scheme)

Figure 7.1.
Countries grouped
by priority
geopolitical vector

SOCIODEMOGRAPHIC DIFFERENTIATION OF INTEGRATION SENTIMENT

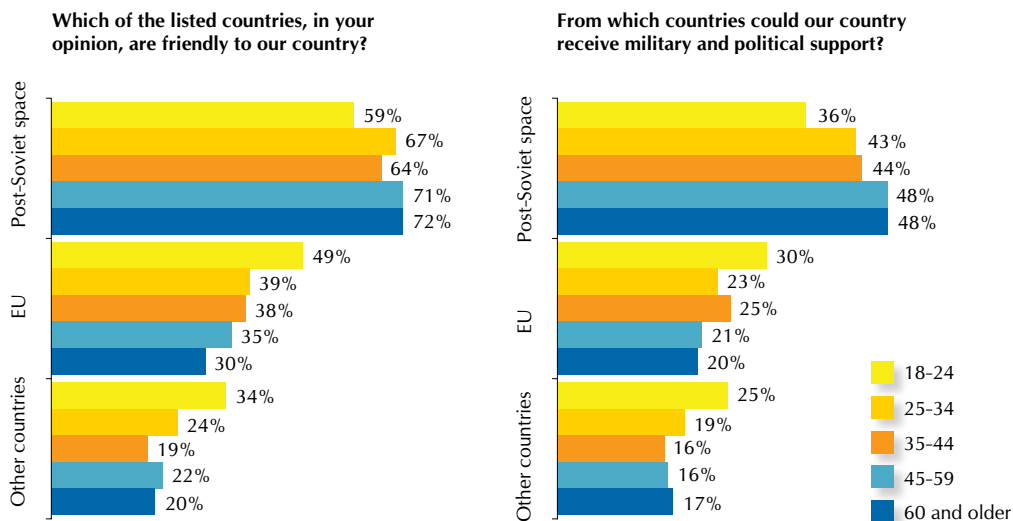
The inclinations that prevail in some countries almost never become dominant (i.e. shared by the overwhelming majority of the population). There is notable differentiation of popular views in practically all countries. In some countries (e.g. Ukraine, Moldova, Uzbekistan) this differentiation can be interpreted as a real split in public opinion resulting from citizens' polar opposite inclinations. Obviously, such differentiation seriously complicates political decision-making on integration issues, since it is difficult to reach a compromise that would satisfy a majority of the population and the main stakeholders.

The nature of this differentiation varies from one country to another and warrants scrutiny, as well as collection of additional data. Of all sociodemographic factors, only the respondent's age materially influences his/her integration preferences: the post-Soviet direction is far less attractive to younger generations, and, vice

versa, orientation towards other countries is becoming more and more common (see Figure 7.2).

Although the disintegration of the Soviet Union was formalised quickly at the political level, at the sociocultural level it is being finalised only now, when the people who grew up after independence become economically active or assume positions in national governments. They are free from the social ties of the Soviet era, and independent development of their own countries seems more natural and habitual to them than development under the Union; they even doubt its very worthiness. By contrast, the older generation has no illusions about the restoration of the former USSR, and they have adapted themselves to most of the consequences of the break-up. This succession of generations coupled with the increasing differentiation of geopolitical sympathies determines certain integration trends which are based on new interests and views rather than the restoration of old ones.

Figure 7.2.
Dependence
of migration
preferences on age
[Ukraine's data]



The three components of integration preference

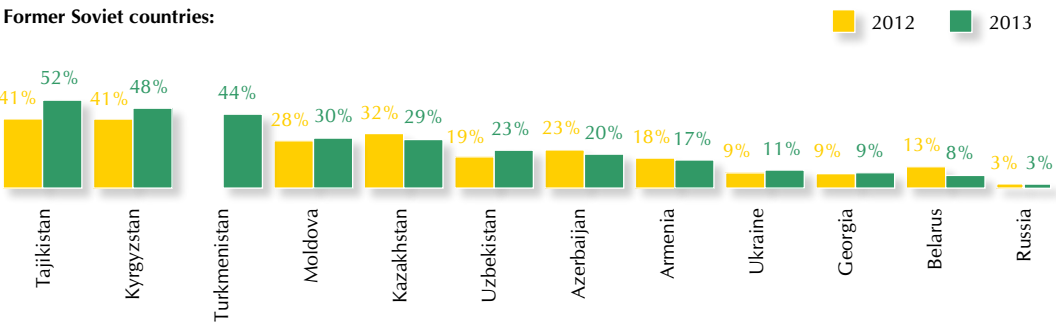
As we mentioned above, integration preferences of a population are measured in three dimensions: sociocultural, economic and political. Thus, integration inclination has three components, and each of them contributes to each country's overall inclination towards each other. Which component makes a decisive (or simply more important) contribution remains an open question. However, when studying integration relations, we elect to start with questions that concern the respondent's personal experience (relatives residing in other countries; which countries he/she has visited; which countries he/she would like

to visit; which countries seem interesting to him/her, etc.) and then proceed to ask questions that concern opinion rather than experience (from which countries should investment or labour resources come from; with which countries should economic alliances be formed), i.e. invite respondents to act as objective “experts” instead of relating subjective, anecdotal evidence. Finally, we ask questions that require “high expert competence”: which countries should be viewed as allies or enemies.

One important factor that influences integration preferences is the respondent’s experience of sociocultural interaction with other countries, including ties with relatives, friends or colleagues residing in such countries. It should be noted that, in addition to the old ethnic diasporas inherited from the Soviet period that were responsible for intensive private communication between citizens of different countries (Ukrainians, Belarusians, Armenians and Azeri in Russia; Russians in Central Asia and Ukraine, etc.), new diasporas have emerged as a result of labour migration in the 21st century (Kyrgyz and Tajiks in Russia; Moldovans in Russia and Ukraine; Uzbeks in Russia and Kazakhstan). These migration flows (both temporary migration and expatriation) strongly influence the integration inclination of many respondents.

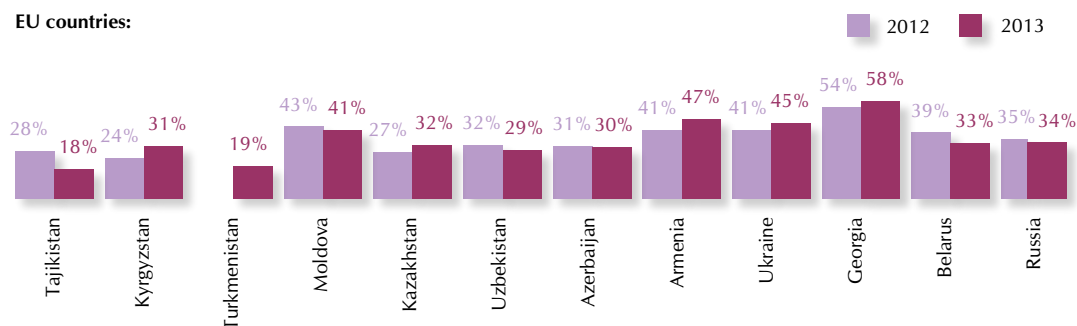
Another important factor is experience relating to education and tourism. However, in these aspects, Russia and the post-Soviet world are far less competitive than other destinations such as the EU, the USA and Arab countries. Russia, Ukraine and Belarus used to be attractive centres of education in the 1990s, but now more and more young people from CIS countries wish to receive professional education in countries further afield.

Figure 7.3.
To which of the
listed countries
would you go to
study (or send your
children to study)?
[three directions]³

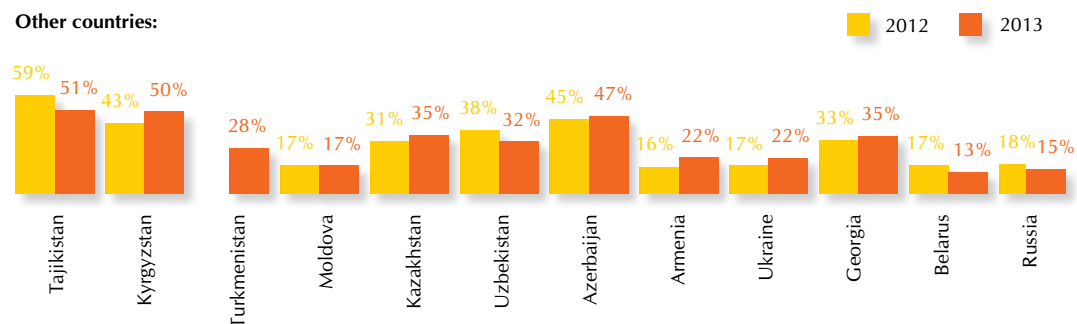


³ Hereafter, in charts of this type (with groups consisting of “Former Soviet countries”, “EU countries” and “Other countries”), percentage is calculated as the share of respondents who have mentioned at least one country from the respective category. For example, in this chart, 52% of respondents from Tajikistan mentioned at least one post-Soviet country, 18% mentioned at least one EU country, and 51% mentioned at least one country from the rest of the world (see the “Tajikistan” column for 2013).

EU countries:



Other countries:



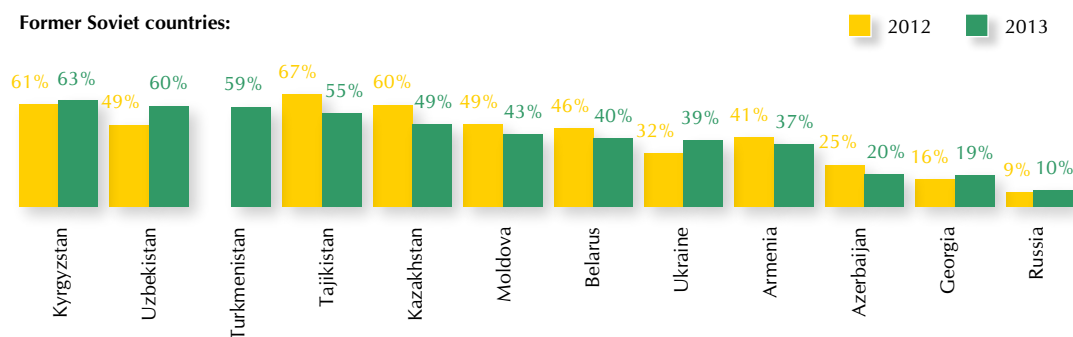
The same is true of respondents' views on scientific and cultural cooperation (see Figure 7.4). In these spheres the potential for integration is formed solely by the persisting interest in Russia expressed by the population of Central Asian countries. However, in Uzbekistan, Turkmenistan and Tajikistan there is also strong interest in the Arab, Persian and Turkic cultural clusters (and in Azerbaijan, moreover, this is the prevailing direction).

The attractiveness of a particular country from the economic perspective is largely determined by the respondents' perception of that country's wealth and economic development in comparison with their own country. Thus, in

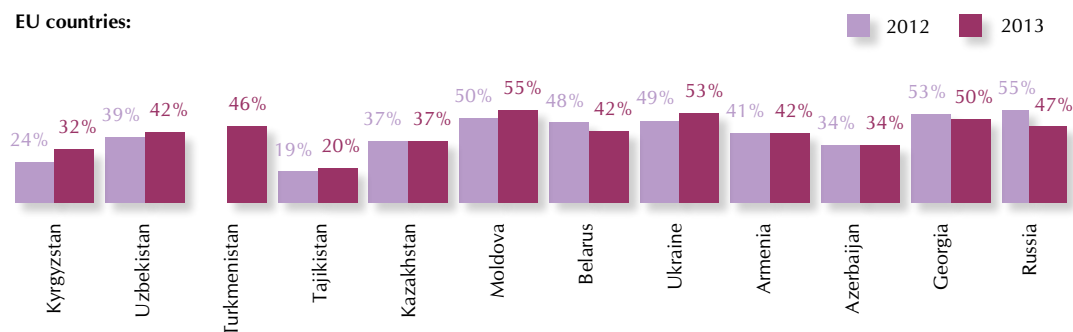
Figure 7.4.

With which countries should our state or companies cooperate in the scientific and technical fields, e.g. conduct joint studies and exchange findings, technology and scientific ideas? (three directions)

Former Soviet countries:



EU countries:



Other countries:

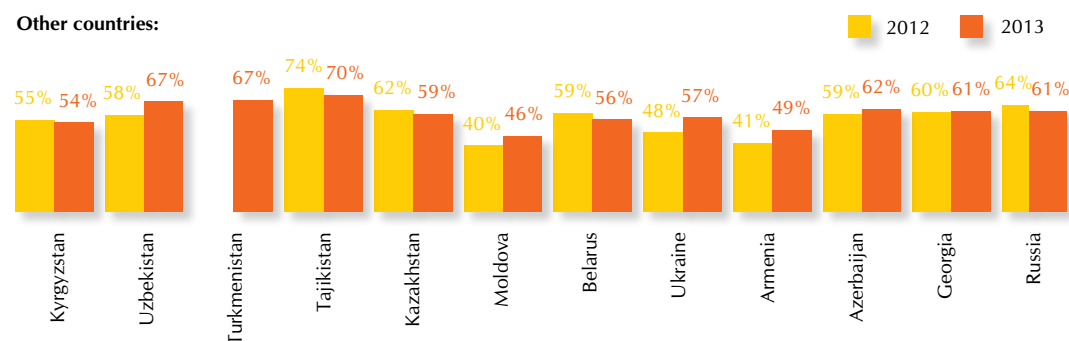
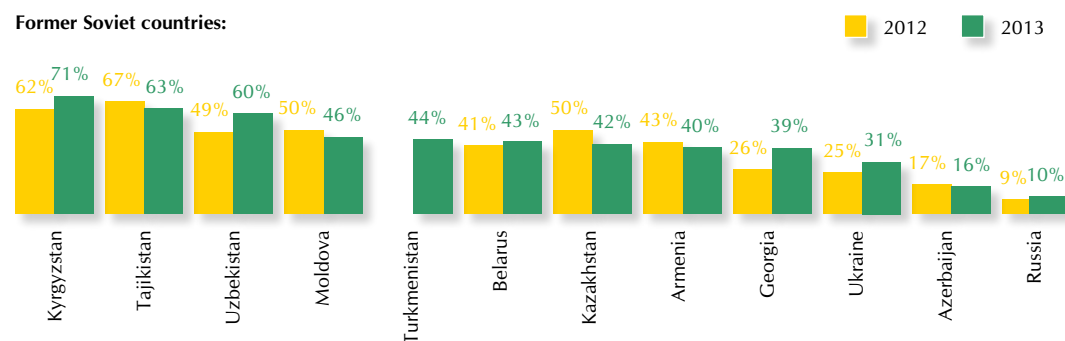


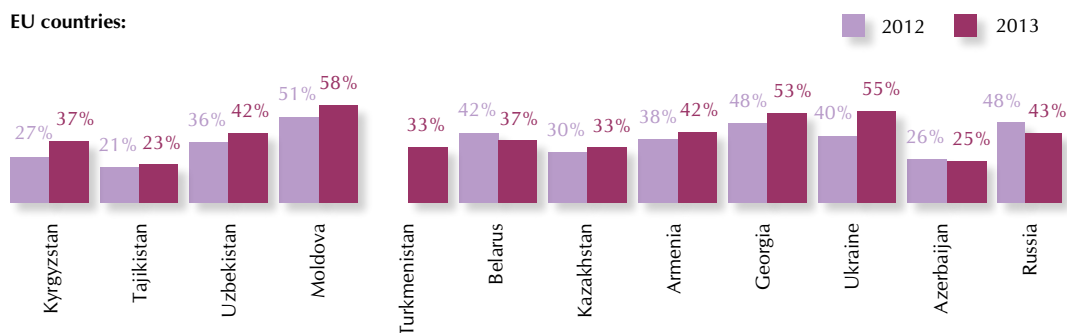
Figure 7.5.
From which
countries should
our country
receive capital and
investment, and
invite companies
and business people
to set up businesses
in our country?
[three directions]

relatively prosperous countries such as Russia, Ukraine, Kazakhstan, Belarus and Azerbaijan, the population favours economic integration with the developed countries of Europe and the USA (in Kazakhstan, however, inclination towards Russia is as strong). This concerns both simple economic integration such as consumer preferences (goods) and more complex concepts such as attraction of labour resources and investments (see Figure 7.5). By contrast, in poorer economies (Kyrgyzstan, Tajikistan, Uzbekistan, Moldova, Armenia), people favour Russian and, more generally, post-Soviet integration. Georgia and Turkmenistan demonstrate multidirectional economic inclinations.

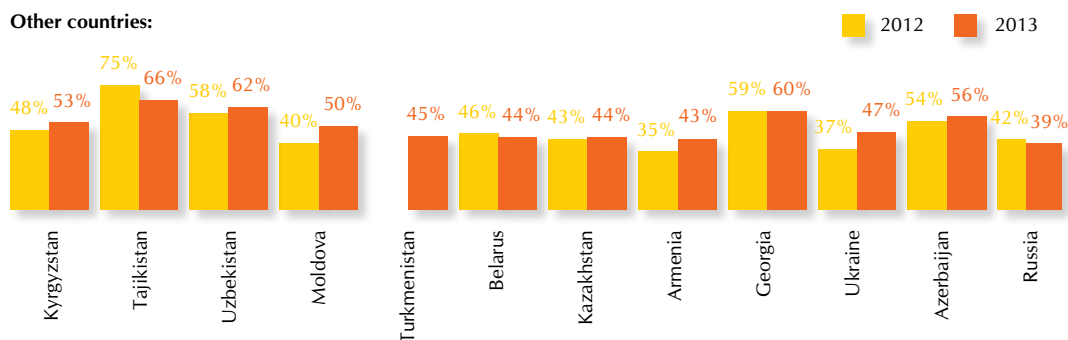
Former Soviet countries:



EU countries:



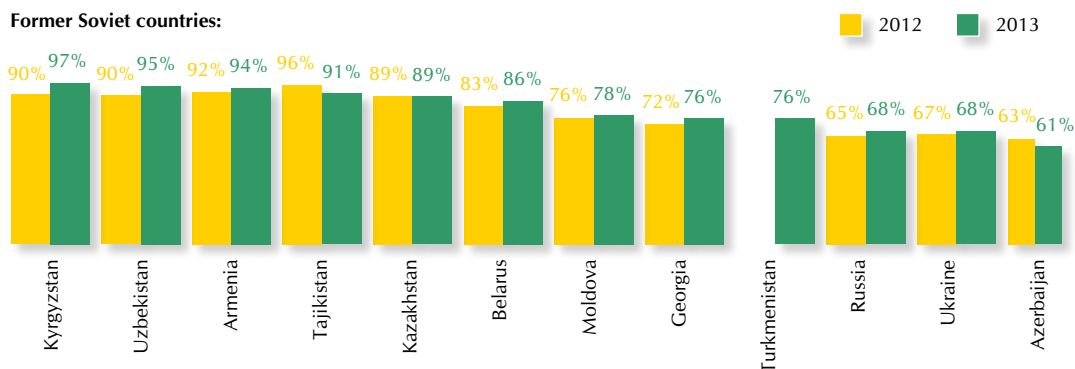
Other countries:



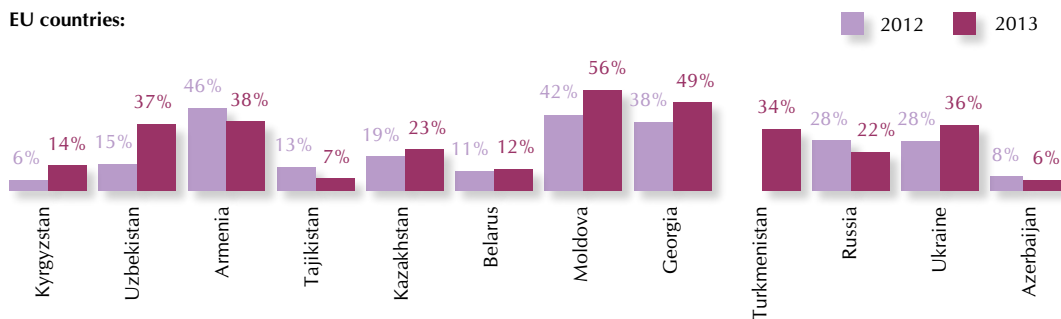
Whereas integration preferences, views and sentiments vary greatly in the sociocultural and economic spheres, in the political (political and military, to be precise) sphere, opinions are largely uniform. In almost all post-Soviet countries, respondents name other CIS countries as preferable political and military allies. The exceptions are Georgia and Azerbaijan with their inclinations towards the USA/Europe and Turkey, respectively. Public opinion also clearly reflects the openly hostile relations in certain country pairs such as Armenia-Azerbaijan, Russia-Georgia, Uzbekistan-Tajikistan and Kyrgyzstan-Tajikistan.

Figure 7.6.
Which of the listed countries, in your opinion, are friendly to our country (i.e. could be expected to support us in times of need)? [three directions]

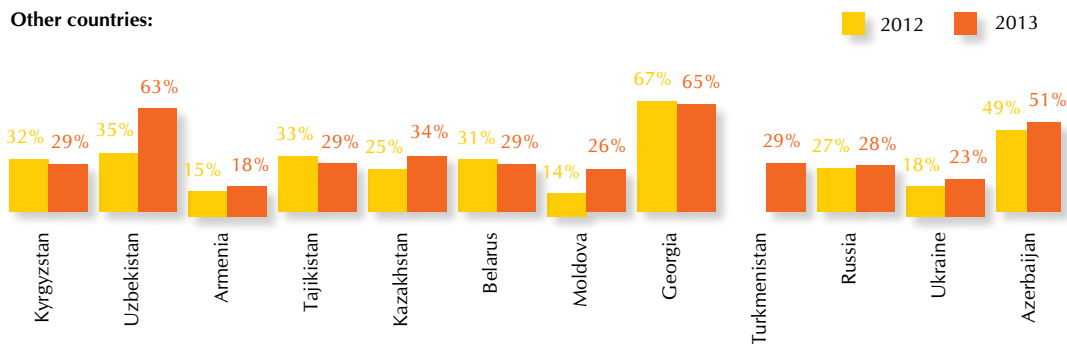
Former Soviet countries:



EU countries:



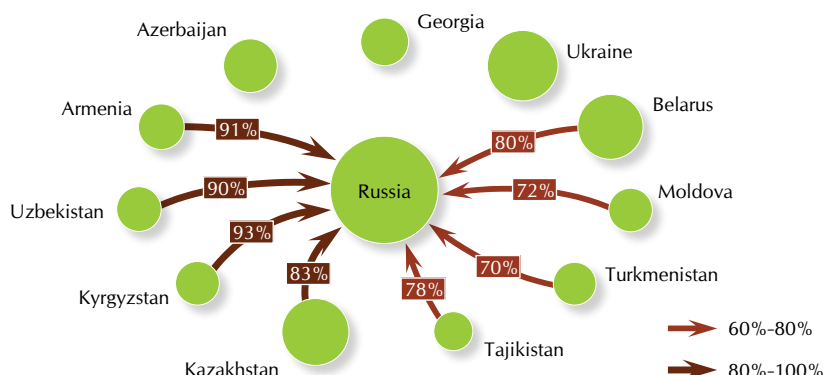
Other countries:



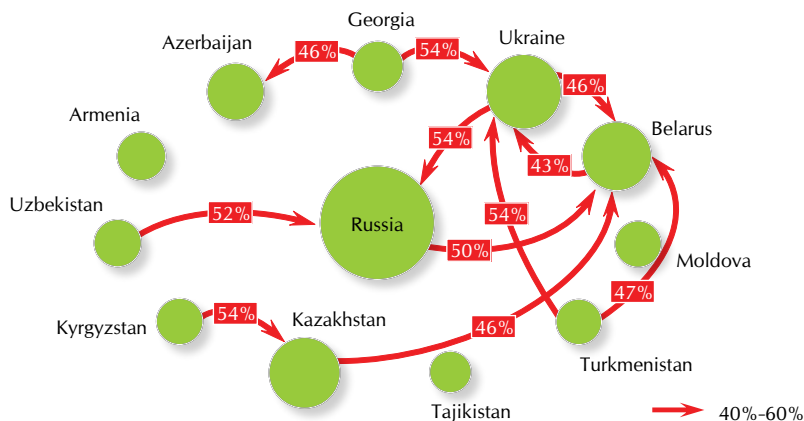
The friendliest country of the post-Soviet space is Russia: it was most frequently mentioned as a “friendly country” by respondents from nine countries (see Figure 7.7). Russia is most frequently regarded as a friendly country in Kyrgyzstan (93%), Armenia (91%), Uzbekistan (90%), Kazakhstan (83%), Belarus (80%), Tajikistan (78%, an 8% decrease from the previous year), Moldova (72%) and Turkmenistan (70%). Russia was not in the top spot only in two countries:

Figure 7.7.

Which of the listed countries, in your opinion, are friendly to our country (i.e. could be expected to support us in times of need)? [Preferences within the former USSR, 2013]⁴



⁴ The chart is divided into two parts to improve readability.



Azerbaijan (25%, second to Georgia, 29%) and Georgia (9%, compared with 5% in 2012). In Georgia, the friendliest country was Ukraine (54%), followed by Azerbaijan (46%).

Thus, in spheres where the population's opinions cannot be based on any personal experience or firsthand knowledge, respondents tend to express the perceptions that prevail in official government releases and the mass media.

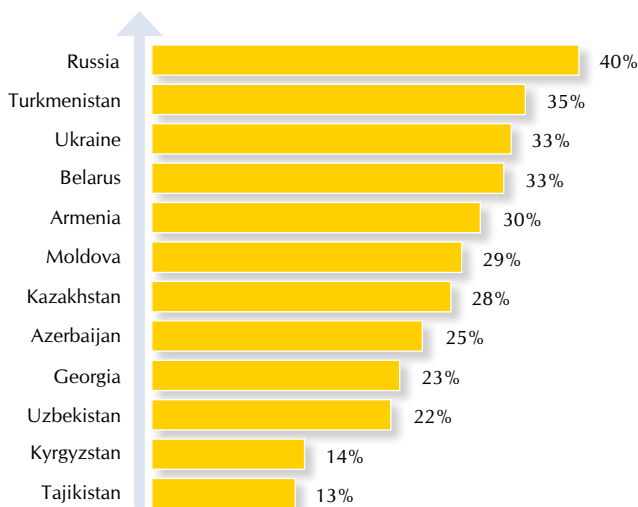


Figure 7.8.

Isolationist sentiment in the countries covered by the projects [average sums of the "No such country exists" and "Difficult to say" boxes for questions asked in each country]

On one hand, such "induced" public opinion can provide a strong basis for support of integration processes, but, on the other hand, it is very sensitive to the position of the country's dominant political forces, which poses certain

risks. The political preferences of citizens appear to be heavily dependent on media propaganda, whereas one would expect the inhabitants of a country to form more of their own, personal opinions.. We can conclude that the political component of integration preferences of the CIS population needs to be supported by the humanitarian and economic components.

Isolationist sentiment in the countries covered by the projects [average sums of the “No such country exists” and “Difficult to say” boxes for questions asked in each country]

The dependence of integration preferences on social welfare and the sense of the country’s self-sufficiency is clearly seen in the degree of isolationist sentiment. Stronger isolationist views recorded in Russia, Ukraine, Belarus or Turkmenistan correlate well with the relatively high levels of life satisfaction in these countries. By contrast, the spread of integration sentiment in Kyrgyzstan and Tajikistan (irrespective of direction) is down to the low levels of social well-being and pride.

Therefore, we can assume that citizens of poorer countries view an alliance with wealthier countries as an opportunity to improve their own situation. In parallel with that, a significant proportion of the population of relatively prosperous countries is reluctant to share their wealth with anyone else, and refuses integration. Such an attitude poses risks to the stability and lifetime of integration groupings and stiffens requirements for mutual benefits from cooperation, including requirements for raising the population’s awareness of such benefits. Otherwise, the perception of “unequal distribution of benefits” may cause the spread of isolationist sentiment in the most developed countries of the region.

PUBLIC OPINION ON THE CUSTOMS UNION AND THE SES

The above distribution of integration preferences was also reflected in the question on advisability of a country’s accession to the Customs Union and the Single Economic Space. Accession to these international alliances is readily supported by respondents from Tajikistan, Kyrgyzstan and Uzbekistan (72–80%), even more readily than in the member countries themselves – Russia, Belarus and Kazakhstan (65–72%). By contrast, in Turkmenistan, Ukraine and especially Azerbaijan, support for economic integration at such a level hardly reaches 50%.

There are no common sociodemographic trends in the post-Soviet population’s attitude towards economic alliances. In many instances, the number of supporters of such alliances correlates with the respondents’ age, but this trend almost never becomes statistically significant. Older generations have a positive perception of post-Soviet integration in general, and of the CU and the SES in particular.

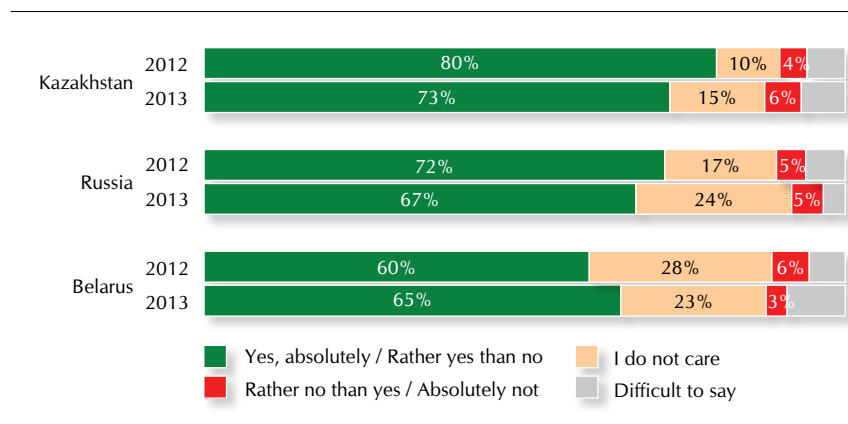


Figure 7.9.

Belarus, Kazakhstan and Russia formed the Customs Union, which eliminated customs duties between these three countries, and the Single Economic Space (effectively a common market). What is your assessment of this decision?⁵

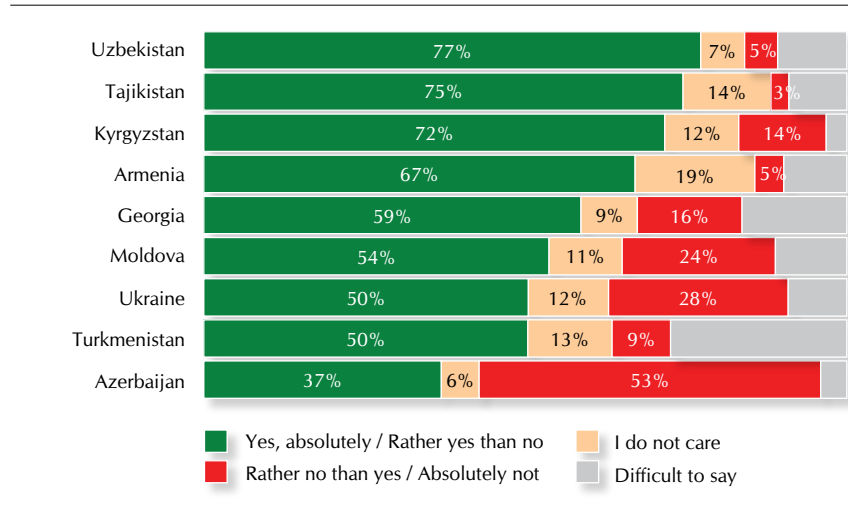


Figure 7.10.

Belarus, Kazakhstan and Russia formed the Customs Union, which eliminated customs duties between these three countries, and the Single Economic Space (effectively a common market). Do you think our country should join them?

Turkmenistan, which joined the project in 2013, is different from other Central Asian countries in terms of its attitude towards the CU and the SES. The country had the highest proportion of "difficult to say" answers. Obviously, the population is poorly informed about economic alliances existing in the post-Soviet space, which allows us to consider the 50% of positive responses obtained in Turkmenistan an optimistic sign: respondents welcome the very idea of integration.

We can analyse attitudes towards the Customs Union and the Single Economic Space by comparing the distribution of answers to the question about attitude

⁵ In the 2012 poll, two different questions were asked (separately for the CU and the SES). The chart shows data relating to the SES question. Such an assumption is permissible for illustration purposes, since the difference in answers to the CU and SES questions in the 2012 poll did not exceed two percentage points.

towards these alliances and the question about preferred goods. Such a comparison allows us to draw the following conclusions.

First, in the Customs Union countries, there is no direct correlation between attitude towards integration groupings and consumer preferences. Citizens of these countries who prefer goods from former Soviet countries are not

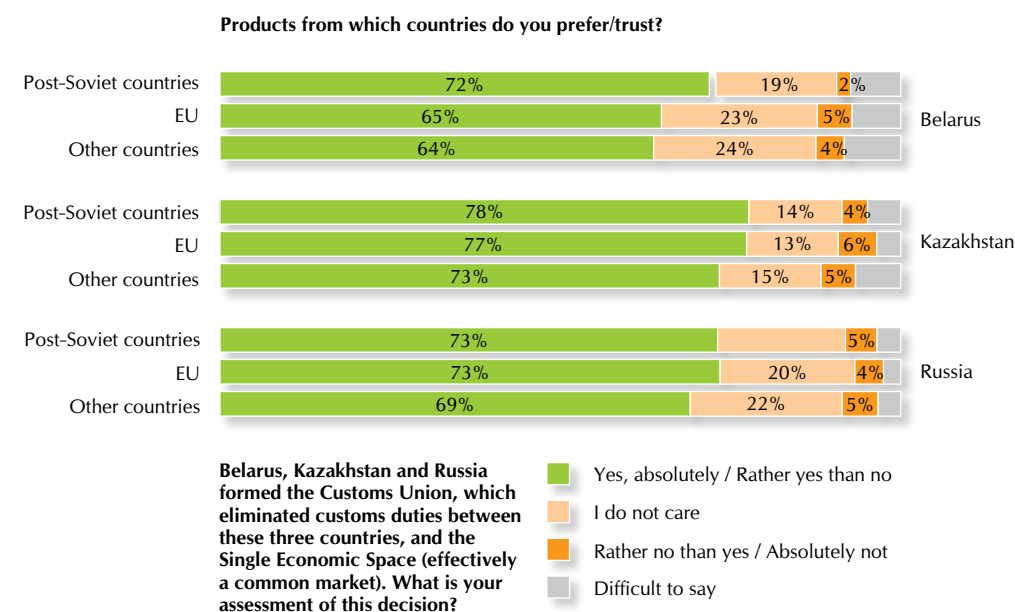


Figure 7.11.

Attitude towards the CU and the SES and answers to the question about preferred goods [Customs Union countries]

significantly more supportive of the CU and the SES (see Figure 7.11). For example, in Belarus, only 72% of those who prefer goods from the CIS region express positive assessment of the CU and the SES; and only 65% of those who prefer goods from the EU express positive assessment of the CU and the SES. The difference is only 7%, which is a threshold of statistical significance. A similar trend is observed in Russia and Kazakhstan. These results allow us to conclude that, to the population of the Customs Union countries, economic alliances are important principally from the political perspective, which characterises a general attitude towards integration rather than an understanding of the rationale behind integration.

Second, the comparison of results obtained in non-Customs Union countries shows a different picture. These countries can be divided into two groups:

- Public opinion in Armenia, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan reproduces the same trends as observed in the Customs Union

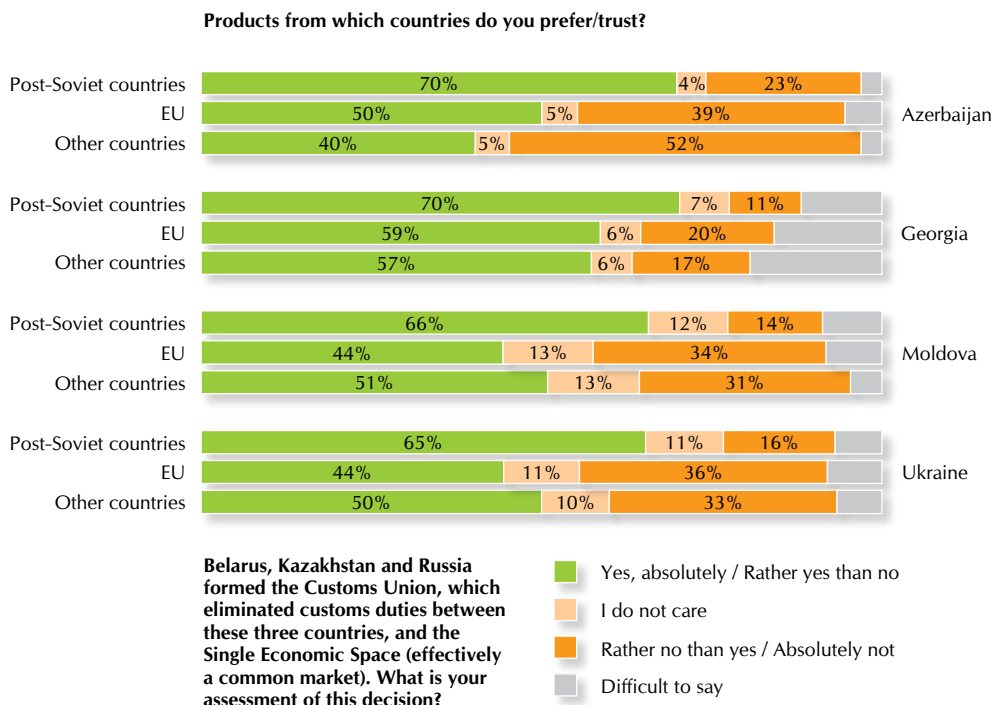


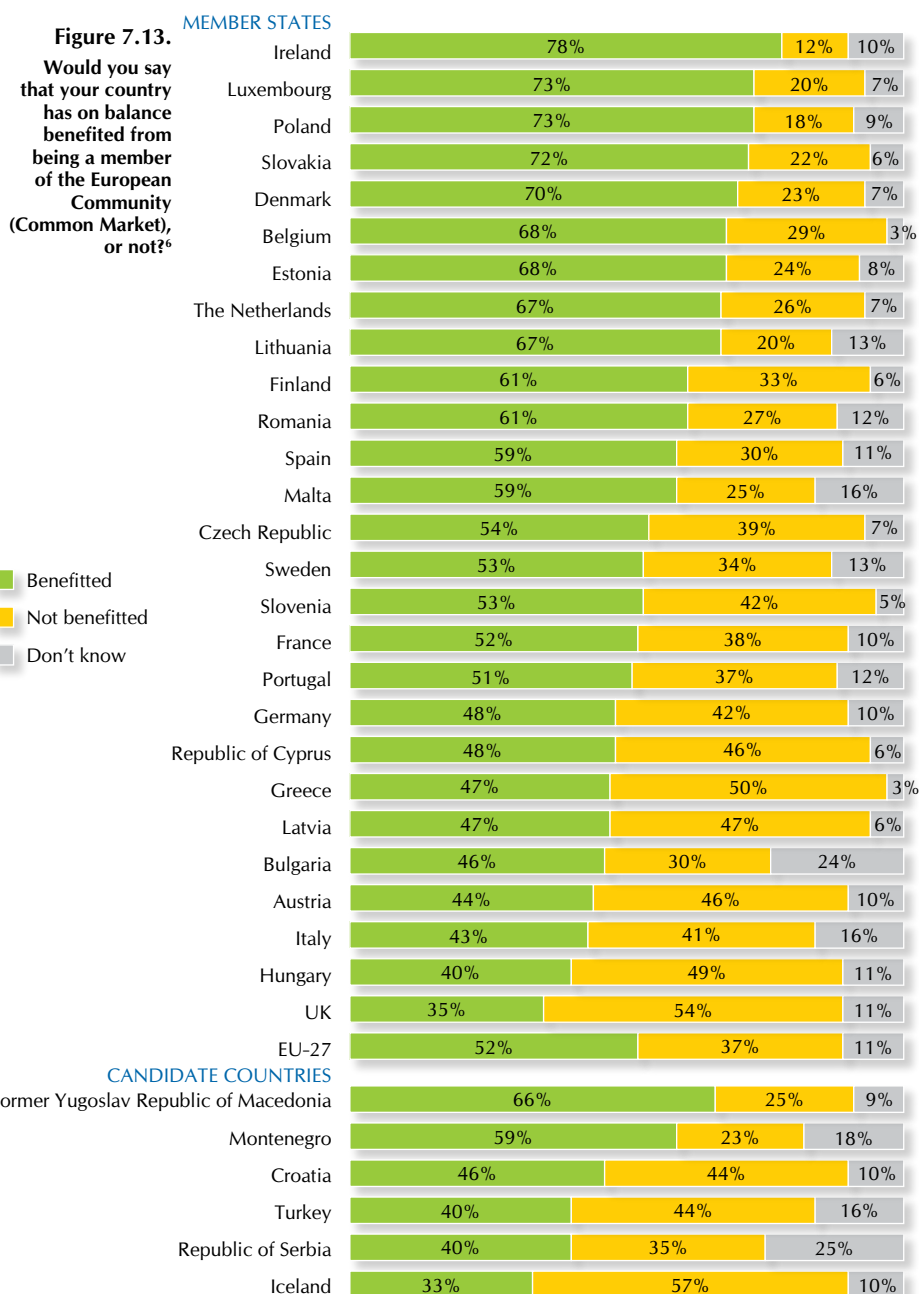
Figure 7.12.
Attitude towards the CU and the SES, and answers to the question about preferred goods [some non-Customs Union countries]

countries: the attitude towards the CU and the SES has no connection with consumer preferences.

- Data on the second group of countries are shown in *Figure 7.12*. Here we can see a direct correlation: respondents who prefer goods from the CIS region are notably more supportive of joining the CU and the SES. That is, in Azerbaijan, Georgia, Moldova and Ukraine, the positive attitude of some respondents towards post-Soviet integration groupings may indicate not only their general integration sentiment, but also their deliberate choice of economic cooperation.

THE PERCEPTION OF INTEGRATION IN THE CIS AND THE EU: COMPARATIVE ANALYSIS

Interesting conclusions can be drawn by comparing the data of the EDB Integration Barometer and the Eurobarometer (see *Figure 7.13*). The assessments of respondents from CU and SES member countries differ insignificantly, and their overall level is fairly high: 65% of positive assessment in Belarus, 67% in Russia and 73% in Kazakhstan. On average, the populations of the EU member countries positively assess the benefits of participation in the common European



⁶ According to Eurobarometer data from the portal of the European Commission. Available at: http://ec.europa.eu/public_opinion/cf/index.cfm?lang=en. The question was asked in EU member countries in May 2011 and in candidate countries in November 2012.

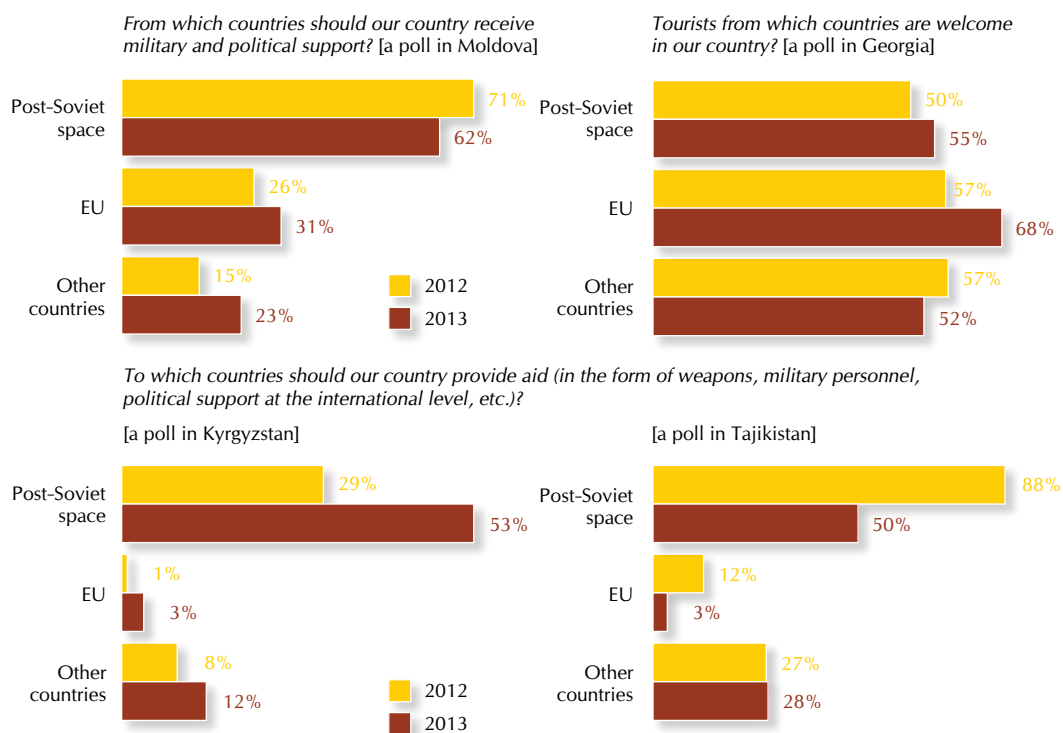
market, but only just: the proportion giving a positive answer is slightly higher than 50%. And in some EU countries the proportion of negative answers is as great, or even exceeds the proportion of positive assessments (the UK, Hungary, Italy, Austria, Latvia, Greece and Cyprus). In other words, the internal perception of economic integration groupings within the post-Soviet space is far more positive than in the EU.

A similar conclusion can be drawn if we consider data obtained from countries which are not members of any integration groupings. Of six candidates for accession to the EU, only Macedonia and Montenegro show in excess of 50% positive assessments of participation in the common European market. By contrast, in the post-Soviet space, only one country demonstrated a significant negative attitude towards the CU and the SES: Azerbaijan (53% pro and 37% contra). In other countries, supporters of economic integration constitute a majority of up to three-quarters of the population or more (72% in Kyrgyzstan, 75% in Tajikistan and 77% in Uzbekistan).

THE DYNAMICS OF INTEGRATION SENTIMENT IN THE CIS

The second wave of the EDB Integration Barometer demonstrated that the population's integration sentiment in the context of relative economic and

Figure 7.14.
Examples of
different types
of integration
sentiment dynamics



political stability is fairly static. Our comparative analysis of the results of the two waves did not reveal any significant changes in integration sentiment which would be common to all post-Soviet countries. At the same time, some changes were recorded in countries that underwent political change in the period between the two polls. For example, integration orientation towards the EU became stronger in Moldova, which is probably attributable to the new pro-Romanian presidential administration. In Georgia, the proportion of respondents orientated towards Europe and the post-Soviet space slightly increased, which is also attributable to changes in the internal political situation and disillusionment with the country's exclusive orientation towards the USA. Finally, the proportion of the population inclined towards integration with the post-Soviet space was on the rise in Kyrgyzstan and dropped in Tajikistan, which reflects the polar opposite assessment of the Kyrgyz-Tajik conflict of the summer of 2012 and the role of the CSTO in that conflict.

PROSPECTS FOR FURTHER STUDIES

On the whole, the second wave of the EDB Integration Barometer ascertained that the methodology selected for the study is correct and efficient. The results are easy to interpret, satisfactory explanations can be found for significant differences between countries, and the dynamic of integration sentiment can be recorded successfully. However, it is clear that, to ensure full interpretation and, as importantly, to forecast integration sentiment, the analysis of subjective data (respondents' answers) should be supplemented with input of other types (official statistics, media surveys, expert opinions, polls of key target groups) and an analysis of the impact of external factors on public sentiment. It would also perhaps be useful to include in the study certain countries that are not presently affiliated with the post-Soviet world but were historically allied to it, such as Latvia, Bulgaria or Mongolia.

The first attempt at implementing a scalable monitoring project showed that many parameters and characteristics of the population's integration sentiment remain fairly static within any one year. Profound changes in geopolitical orientation occur in parallel with generation trends, i.e. at an interval of 6-7 years (this is the recently adopted timeframe for change of a generation cohort). Therefore, it would be reasonable to measure public sentiment at intervals of 3-4 years and in the meantime to focus on the social groups that are most sensitive to information (political and business circles, professionals, etc.).

In any case, our periodic measurement of integration sentiment in the CIS region at the humanitarian level, in our opinion, is worth continuing.

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8

Shifts in Sector Structure of Mutual Direct Investments of the CIS Countries

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The paper presents new results of the joint project “Monitoring of mutual investments in the CIS”¹, implemented by the Institute of World Economy and International Relations (IMEMO) of the Russian Academy of Sciences and the Centre for Integration Studies of EDB. It shows the sectoral structure of foreign direct investments made by various post-Soviet countries in the CIS region. It explains the methodology of the analysis of structural changes in the investment stock.

In late 2011, the Institute of World Economy and International Relations of the Russian Academy of Sciences and the Centre for Integration Studies of EDB launched a multi-year joint programme of study of foreign direct investment (FDI) in the CIS countries. Using this programme, it is planned to significantly expand the empirical basis for the analysis of corporate integration in the Post-Soviet space, as well as to obtain new scientific conclusions about the processes of trans-nationalisation of business and to develop recommendations for further

¹ http://www.eabr.org/e/research/centreCIS/projectsandreportsCIS/invest_monitoring/

development of the Eurasian regional integration. In autumn 2012, the results of the pilot project of IMEMO and EDB were presented, which reflected the main trends of mutual direct investments of the CIS countries and Georgia (Kuznetsov, 2012).

At the same time, areas for further productive development of monitoring of cross-border investments in the CIS were identified. In particular, identifying within the framework of the pilot project the approximate extent of the mutual FDI stocks in individual countries and sectors of the economy, it was decided to study in detail the sectoral shifts in the structure of these investments, occurring in the context of the global crisis. This paper focuses on the methodology and the results of relevant studies in the second half of 2012. At the same time, in May 2013 a regular update of information on transactions was performed, which affected not only the information at the end of 2012, but a portion of previously collected information. The first section of the paper addresses the issues associated with the analysis of the sectoral structure of mutual FDI in the CIS, the second section examines the differences in FDI dynamics in different sectors, and the third shows the specifics of Azerbaijan, Ukraine and Kazakhstan.

SECTORAL ANALYSIS OF DIRECT INVESTMENT OF THE CIS COMPANIES

Adequate information on the sectoral structure of FDI for the analysis of corporate integration in the CIS is important for two reasons. First, due to varying capital intensity of different sectors, the importance of the projects is provided by uneven FDI stocks. Thus, accumulated investments in major foreign subsidiaries of a number of oil and gas and telecommunications companies in the region exceeded \$1 billion. In the same period, for example, all Ukrainian sewing factories of "Gloria Jeans" corporation – the leader of light industry in Russia – received about \$50 million in total.

Second, the impact of cross-border investment in the development of regional integration or modernisation of the economy receiving FDI varies greatly depending on the industry. In particular, for the CIS region it is shown in a number of industry researches of EDB (Kovalin et al, 2012; Absametova et al, 2012).

Choice of any official industrial classification to analyze the data that we collected during the monitoring of mutual investments in the CIS countries and Georgia does not seem to be the best solution. Thus, only at first glance, the current All-Russian Classifier of Types of Economic Activity (OKVED), although it repeats with minor variations the International Standard Industrial Classification, allows for an unambiguous and understandable to all specialists breakdown of investment projects by sectors and industries. On the one hand, the names of some types (subtypes) of economic activity are quite lengthy, and the degree of fragmentation in different sectors varies. Moreover, given

the sectoral structure of the CIS countries, the structure of OKVED proves to be not very convenient for specific calculations in the CIS mutual investments monitoring database. On the other hand, due to the diversification of business of many multinational corporations, their representatives have the ability to specify a large number of codes by OKVED, while the majority of investment projects are still known to experts by their main specialisation. Rejection of specific terms of OKVED in this case frequently relieves growing irritation of companies.

No coincidence that many reputable business studies use their own sectoral classifications. The examples may include the lists of leading Russian companies (Expert-400, 2012), international rankings of leading multinational corporations in developing and post-socialist countries (Sauvant, ed., 2011) and others. After analysing the structure of our CIS mutual investments monitoring database, as well as the specifics of calculations for the analysis of the dynamics and structure of FDI, we came to the idea to create our own model of two-tier classification of industries. In general, it relies on OKVED, which allows to quickly jump directly to the official classification. However, to obtain generalised data, we use our own list, which will be supplemented as the database is maintained. So far it includes 15 large cross-industry complexes or groups of industries, called sectors, while the second tier is formed by 74 industries (see Table 8.1).

Table 8.1.

List of sectors and industries used in the CIS mutual investments monitoring database

Sectors	Industries
Agricultural and food complex	Crop growing, including elevator facilities Processing of crop products Production of bakery and confectionery products Fish industry Livestock and meat processing Dairy production Production of juices and mineral water Brewing industry Production of alcoholic beverages Cigarette production
Fuel complex	Crude oil and natural gas production Oil refining Gas processing Transportation and sale of gas Coal mining
Steel complex	Iron ore mining Coke production Production of pig iron, steel and rolled products Production of iron and steel pipes Manufacture of fabricated metal products Collection and recycling of scrap metal
Non-ferrous metal complex	Mining non-ferrous metal ores Gold mining and processing Uranium ore mining and processing Production of non-ferrous metals

Sectors	Industries
Machine-building complex	<ul style="list-style-type: none"> Manufacture of agricultural machinery Production of cars and trucks Production of vehicles, other than cars Production of machinery and equipment Production of electrical and electronics devices Arms production
Chemical complex	<ul style="list-style-type: none"> Basic chemicals (production of sulfuric acid, chlorine, etc.) Petrochemicals, basic organic synthesis chemistry Manufacture of plastic products, including plastic pipes Production of mineral fertilizers Perfume and cosmetic manufacture Paint and coating industry Pharmaceutical production and biotechnology
Other manufacturing industries	<ul style="list-style-type: none"> Pulp and paper production Manufacture of wood and of wood products Manufacture of furniture Textile and garment production Fur production
Utilities	<ul style="list-style-type: none"> Electric power industry Gas networks and housing and public utilities
Construction complex	<ul style="list-style-type: none"> Production of cement and concrete products Production of refractories Glass production Production of insulation and roofing materials Production of other construction materials Construction and real estate development
Transport complex	<ul style="list-style-type: none"> Air transport Rail transport Ports and maritime transport Warehousing and logistics Mainline pipelines
Communications and information technology	<ul style="list-style-type: none"> Telecommunications (telephone and Internet) Software development and system integration Media and advertising
Wholesale and retail trade	<ul style="list-style-type: none"> Chain stores Petrol stations Distribution networks Raw materials and semi-finished goods wholesale trade (oil, electricity, fertilizers, steel products, etc.) Finished goods wholesale trade (cars, electronic components, cosmetics, medicines, etc.)
Finance sector	<ul style="list-style-type: none"> Banking Insurance Real estate (excluding construction) Other financial services (private equity funds, brokerage, etc.)
Tourist complex	<ul style="list-style-type: none"> Accommodation industry Catering industry Tour operators and travel agencies
Other service industries	<ul style="list-style-type: none"> Education Repair Gambling industry

Given the fact that our database includes more than 1000 projects, there is an average of 14 projects for each industry. However, there is a great disparity between sectors and industries in the number of completed projects. The following is an analysis of the proportion of projects that received FDI by different industries. With that, we must consider a significant diversification of business of many of the leading investors. One of the most striking illustrations is the Russian group VS Energy, ranking 10th among the leaders in mutual investments in the CIS, which has invested several hundred million dollars in steel complex, tourist complex and utilities (electric power industry). More examples are associated with diversification along the value chains. For example, LUKoil has made substantial investments both in oil refining industry of various CIS countries (crude oil and natural gas), and in companies of chemical complex (petrochemicals, basic organic synthesis chemistry), as well as in wholesale and retail trade (petrol stations).

DYNAMICS OF MUTUAL INVESTMENTS IN THE CIS IN 2009-2012, BY INDUSTRIES

In the overseas expansion of Russian transnational corporations that dominate among the investors in the CIS, three stages are distinct – slow process of internationalisation in the 1990s, export boom of FDI in the 2000s (before the

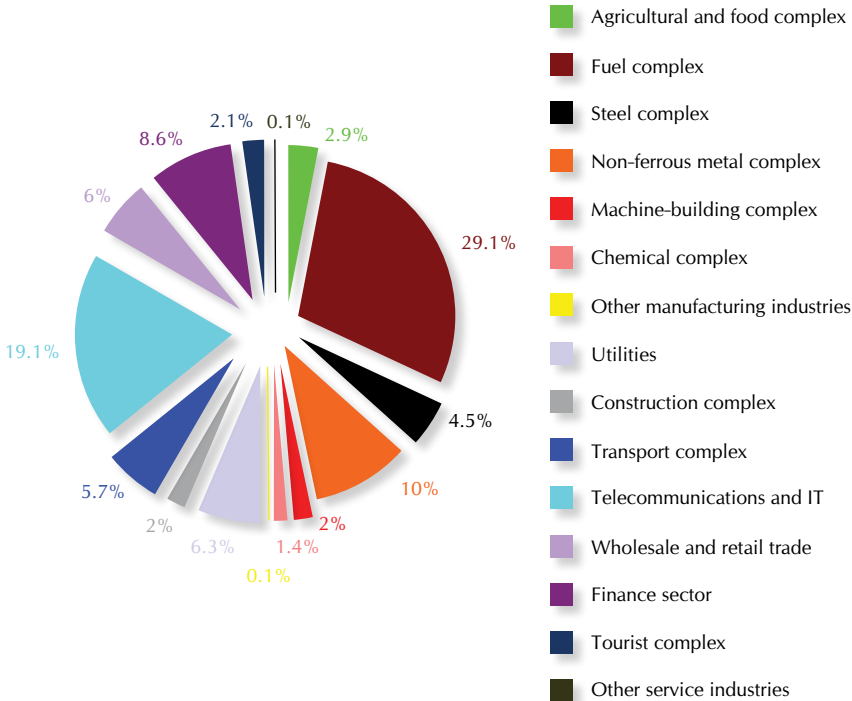


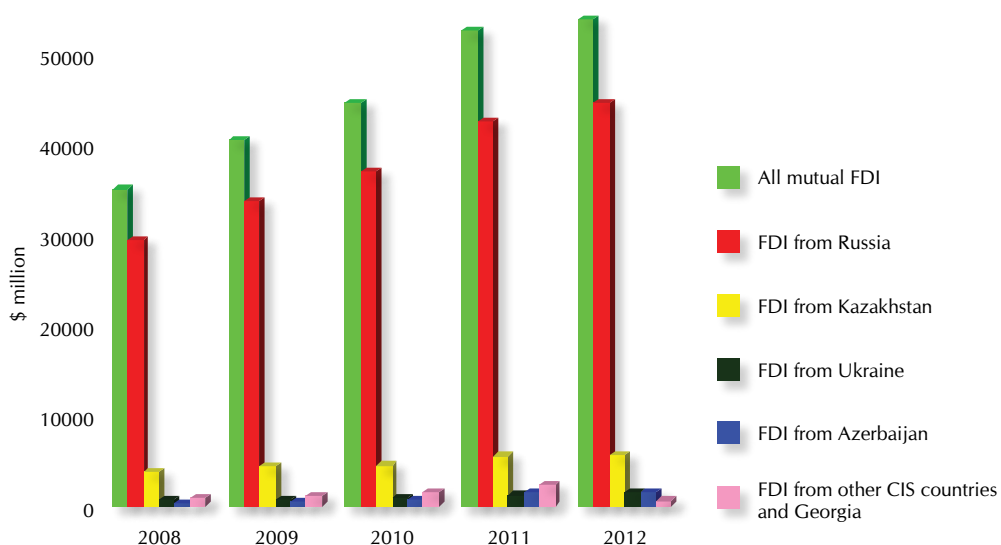
Figure 8.1.
Mutual FDI stock
structure of the
CIS countries and
Georgia at the end
of 2008 by industries

impact of the global crisis) and, finally, transformation of foreign activity after 2008 (Kuznetsov, 2011; Vinokurov and Libman, 2012). Similar dynamics are demonstrated by investor companies from other countries of the CIS.

Since transformation of FDI in the context of the global crisis is inevitably associated with structural shifts, of particular interest is the change of the role of various economy sectors in the accumulated amount of mutual investments in the CIS. At the end of 2008, the fuel complex accounted for 29.1% of this amount, and communication and information technologies for 19.1% (see Figure 8.1). Shares of non-ferrous metal complex (10%) and finance sector (8.6%) were roughly comparable. Utilities, wholesale and retail trade, transport sector and steel complex also stood out.

Despite the outbreak of the global economic crisis, which struck many post-Soviet companies, in 2009–2012 there was gradual build-up of mutual FDI. Their stock increased by 53.5% over four years (see Figure 8.2). This indicates a certain stability of corporate integration processes in the CIS against external shocks. Moreover, the involvement in corporate integration of business representatives from different countries of the CIS accelerated. At the absolute increase in FDI stocks of all leading investor countries, the share of Russian outward FDI declined from 84% at the end of 2008 to 82.6% at the end of 2012. Kazakhstan's share also declined (by 0.4%), but the share of Azerbaijan and Ukraine significantly increased, which in this case were almost equal in terms of the value.

Figure 8.2.
Dynamics
of mutual FDI of the
CIS countries
and Georgia
in 2009–2012



Among individual sectors by the end of 2012 the largest increase in the share (by 0.8%) was demonstrated by construction complex, with utilities sector slightly behind it. The share of agri-industrial and tourist complex has become more noticeable. In contrast, the share of telecommunications and IT declined very significantly (by 2.5%). This is partly explained by the specifics of investment in telecommunications (substantial investments are made to hold captured market position), as well as complexities of adequate assessment of FDI stocks. Long-term (non-current) assets remain to be an important indirect indicator, as in other industries. However, in case of telecom companies their amount as reflected in their financial statements is two to three times lower than the accumulated investment in infrastructure claimed by investors. With that, in general, the sectoral structure of mutual FDI has undergone no radical changes (see Figure 8.3).

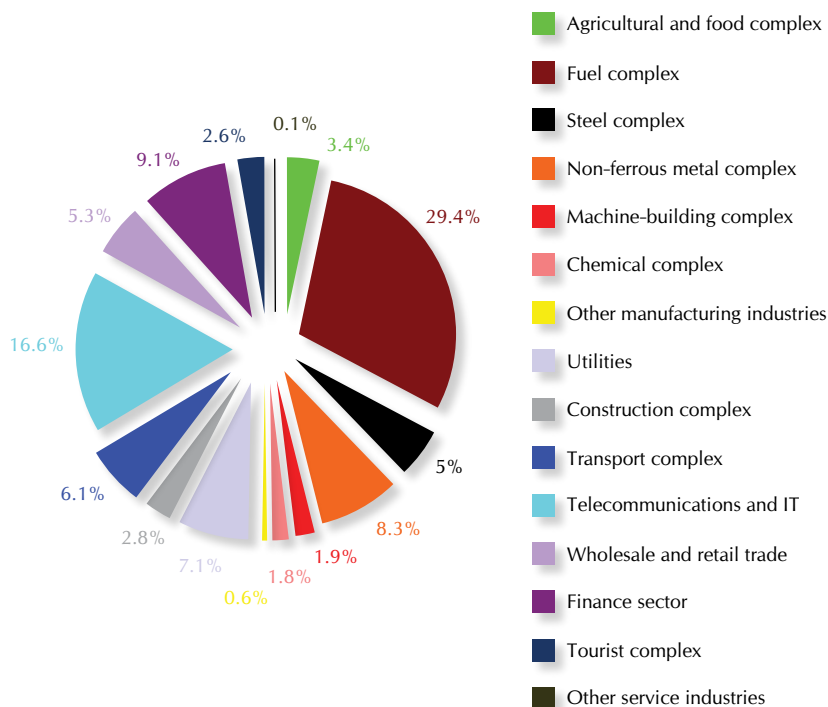


Figure 8.3.
Mutual FDI stock
structure of the
CIS countries and
Georgia at the end
of 2012 by industries

It should be noted that significant changes in the structure of mutual investments are still provided by individual projects of large companies. Thus, in eight of them, the increase in four years exceeded \$0.5 billion (see Table 8.2). Russia's leading multinational corporations especially stand out.

Investor	Investment sector	Country receiving FDI	Investment object	FDI growth in 2009–2012 (\$ million)	FDI stock at the end of 2012 (\$ million)
Gazprom	Fuel complex	Belarus	Beltransgaz	3750	5000
VimpelCom	Telecommunications and IT	Ukraine	KyivStar and other companies	1981	3671
VEB	Steel complex	Ukraine	Industrial Union of Donbass	1000	1000
VEB	Finance sector	Ukraine	Prominvest-bank	755	755
Capital Partners*	Construction complex	Russia	Metropolis Shopping centre	700	1000
LUKoil	Fuel complex	Uzbekistan	PSA in Southwest Gissar	728	2098
Azerbaijan Railways, GNFA	Transport complex	Georgia	Karzakhi-Marabda	575	775
VimpelCom	Telecommunications and IT	Uzbekistan	KyivStar and other companies	511	861

Table 8.2.
Projects with largest FDI in 2009–2012 in the CIS mutual investments monitoring database

Note: *Kazakh investor resold the project to investors outside the CIS in early 2013

We should give one more comment on our methodology for analysing FDI dynamics. For some projects (mostly medium-sized) implemented by companies with a low degree of transparency, few publications are available, that contain only data on planned or final cost of the project. In such cases, we were considering uniform distribution of stated investments by periods when the actual increase of investments was performed (for example, active construction of a new foreign plant). If no further modernisation activities (or other forms of project development) were reported for the following period, or, conversely, material facts were disclosed that led to the impairment of previous investments, we considered the amount of FDI stock to be stable.

SPECIFICS OF INDIVIDUAL POST-SOVIET STATES

Fundamental changes in the structure of Russian FDI stock in the CIS are reflected as the most important industry shifts and in general in mutual direct investments in the region. Therefore, of the greatest interest is the comparison of changes in the structure of FDI of Kazakhstan, Azerbaijan and Ukraine made in other post-Soviet republics, which are often in the shadow of the changes associated with Russian investments.

The growth of the Azerbaijan's outward FDI stock in the CIS and Georgia of 4.3 times over the four years could not but cause a significant change in the structure of these investments. However, rather narrow international specialisation of the economy of Azerbaijan restricts the possibility for fundamental shifts. The first place (because of the development of the projects for modernisation of

railways and terminals in Georgia started in the 2006–2007) still remains with the transport sector, and its importance in the structure of the Azerbaijanian FDI has not changed. The second place is held by wholesale and retail trade (due to SOCAR, which greatly expanded the network of petrol stations in Georgia and Ukraine). Investments in the Georgian gas networks increased several times, which according to our methodology were referred to the fuel complex (and this is justified as the investor is Azerbaijan's oil giant SOCAR). The International Bank of Azerbaijan increased in 2011 the share capital of its subsidiary bank in Russia, however, the proportion of the financial sector in Azerbaijan's direct investment in the former Soviet republics declined over the four years from 9 to 3%. In 2009, Azersun Holding started to invest in Russia. Nevertheless, the share of its investment in the agricultural sector in the sectoral structure of Azeri FDI in the region slightly exceeds 1%.

During 2009–2012, the structure of Ukrainian FDI in the CIS countries and Georgia has undergone significant changes. Despite the fact that the share of Ukraine in the mutual investment in the Commonwealth changed by only 1% (from 1.9 to 2.9%), the absolute volume of Ukrainian FDI stock increased by almost 2.5 times. For a long time the leadership was held by fuel complex, and, in contrast to Russia, not because of the oil and gas industry, but due to coal mining. However, the increase of Ukrainian FDI was much more dynamic in agricultural and food complex. In 2012, this sector came in first place, first leaving behind steel complex, which is another key sector of the international specialisation of Ukraine (now the industry is already on the 5th place, although it was on the 2nd four years). "Other manufacturing industries" sector gained the third place due to a major wood processing project in Russia. Among other industries, the financial sector can be noted (4th place), as well as wholesale and retail trade.

Although FDI of Kazakhstan accumulated in the CIS and Georgia for the four years under review increased only 1.5 times, due to divergent trends in individual sectors the sectoral structure of investments has changed significantly. The largest negative impact of the economic crisis was suffered by financial sector (due to significant drop even in absolute index the sector's share dropped by 8.7%) and the transport sector (due to the sale of warehouse and logistics facilities). However, tourism and construction complexes, also largely related to real estate market conditions, increased their share in Kazakhstan's FDI stock in the CIS countries and Georgia. In general, these four sectors by the end of 2012 accounted for almost 70% of Kazakhstan's investment in the region. With that, agricultural and food complex went to the second place. The most dynamic in the industry in 2009–2012 was demonstrated by chemical complex and non-ferrous metal complex. Some other sectors also stand out. As a result, in terms of FDI stocks and their degree of industrial diversification, Kazakhstan gives way in the CIS only to Russia.

Due to low level of FDI, other CIS countries are not of particular interest for analysis. The most striking event of the end of 2011 and beginning of 2012 was the sale of assets of Bidzina Ivanishvili in Russia in order to win the elections in Georgia. As a result, Georgian FDI in general declined sharply in the CIS countries, and, of course, their structure has changed.

Our analysis has shown preservation of growth of mutual FDI in the CIS region, not only in general but also in the context of the majority of individual industries and countries. Continued monitoring of these investments over time will allow to significantly expand the statistical information. This will enable to assess the impact of political integration projects in the Post-Soviet space on the dynamics of corporate integration in various sectors of the economy.

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9

Belarusian Commodity Distribution Companies in CIS Countries*

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Overseas investment activities of Belarusian companies were, for a while, poorly covered in scientific publications. Such insufficient attention to the issue is associated with modest Belarusian investments. The cumulative level of foreign direct investment (FDI) at the end of 2011 was only \$290 million, being on the same level with such countries as Botswana, Bangladesh and partially recognised Republic of Kosovo (IMF, 2011). Even for a CIS country, Belarusian investments are modest and fall behind investments by Russian, Kazakhstani, Ukrainian and Azerbaijani companies (EDB, 2012). At the same time, over the last decade there is a clear trend of increasing number of companies with Belarusian capital, especially in Russia, Lithuania, Latvia and Ukraine where there are already hundreds of such companies. Such contradiction can be explained by the fact that the majority of Belarusian direct investments are made by state-owned exporting companies and such investments are geared at the promotion of Belarusian products in the neighbouring countries rather than at the establishment of new businesses abroad.

A key feature of the Belarusian economy is that it is export-oriented; exports comprise over 50% of the country's GDP. At the same time, Belarusian trade balance is negative, though demonstrates a downward trend (RB, 2012). The foreign trade deficit is mostly driven by a negative trade balance with Russia,

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which has been only partially offset by increased exports to other countries. Therefore the Belarusian Government has been traditionally focusing on creating enabling environment for export development by continuously improving institutional and legislative frameworks for export promotion (though the results are not always consistent). According to the Prime Minister M. Myasnikov, for Byelorussia the issues of struggle for raw materials and product markets go beyond economic categories and are elements of national security (Belarusian News, 2012).

The primary instrument for promoting the expansion of Belarusian produce to foreign markets is the so-called commodity distribution network (CDN), i.e. 'a community of foreign legal entities and persons and overseas business units of Belarusian legal entities, including their branches and representative offices, which sell or sell and service commodities (products) manufactured/produced by Belarusian producers (RB, 2012).

In this article, written in the framework of the monitoring of mutual CIS investments (a project, developed by IMEMO and the EDB Centre for Integration Studies), we will try to determine what role the CDN plays in the system of state support to Belarusian exports, review the dynamics of its development in the CIS countries and evaluate efficiency of CDN as an instrument of foreign trade policies. The study is based on monitoring Belarusian CDN (from 2007 to the first quarter 2013) based on the analysis of official Web sites of Belarusian state-owned companies, corporations and agencies, statistics produced by the Ministry of Trade as well as materials of the Commodity Distribution Network of the Republic of Belarus, a journal set up by the ministry for promoting foreign trade. The purpose of the study is to provide scientific analysis of yet unexplored role of commodity distribution network as the means of trade expansion for Belarusian business abroad, first of all, in the post-Soviet states.

COMMODITY DISTRIBUTION NETWORK AS AN EXPORT SUPPORT SYSTEM

Pursuant to the Resolution of the Belarusian Council of Ministers a commodity distribution network includes the following types of agents:

- CDN entities with Belarusian authorised capital or its share. This category includes foreign legal entities (unitary enterprises or business entities), established by one or several Belarusian legal entities, including branches and representative offices of Belarusian companies. Their business profile is to sell and (or) service commodities under a contract with a producer or an authorized entity.
- Assembly plants are CDN agents, including those with producer's authorized capital, which assembly, from supplied by producers knock down kits (assembly units, components, spare parts, parts and other items), and produce final outputs and sell such outputs.

- Dealers are CDN agents which sell and (or) service producer's goods on their own behalf and for their own account.
- Distributors are CDN agents which sell goods on producer's behalf for their own account.
- Foreign network commercial organisations are foreign legal entities which sell producers' goods through their subsidiary commercial organisations (branches).

CDN agents with Belarusian capital represent only the tip of the iceberg: according to the Belarusian Ministry of Trade, as of the beginning of 2013 there were 347 CDN agents with Belarusian capital operating abroad, whereas the total number of commodity distribution companies was over 3,800. Theoretically, CDN agents with Belarusian investments include even those where Belarusian capital accounts for a few percent only. In practice, however, Belarusian investors tend to make CDN equity either fully Belarusian or with small participation of foreign capital.

As Mr. Stepanenko, Deputy Minister of Trade, Byelorussia, noted back in 2007, 'the created commodity distribution network with Belarusian investments should become a kind of skeleton on which indirect agents will be based' (Stepanenko, 2007). 'It is not possible to create CDNs purely with Belarusian investments; it is costly and not always efficient'; therefore the key focus in promoting goods in foreign markets should be made on developing dealer networks with no direct investments by Belarusian companies.

The CDN creation as well as other measures to support Belarusian exports (building of contractual and legal framework for foreign trade development, holding of exhibitions and fairs abroad) are coordinated by the Ministry of Trade. The transition to the centralised CDN creation will, according to the Belarusian Government, help to minimize the need for cooperation with local commercial networks and to put own distribution in place.

The largest number of enterprises among state-owned corporations and agencies (including ministries and regional and municipal administrations) is related to the Ministry of Industry, for example, such large enterprises as Minsk Tractor Plant (MTP), BelAZ JSC, Minsk Motor Plant (MMP), Belkard JSC, etc. Worldwide, the Ministry has 121 commodity distribution companies with Belarusian investments. Bellegprom, Belneftechim and Bellesbumprom are ranked second, third and fourth (with 52, 31 and 25 companies respectively). Belgospisheprom rounds out the top five leaders as it is in charge of 16 CDN agents.

Speaking about specific companies, the largest number of CDN agents in the CIS countries were established by BelAZ (27), Minsk Tractor Plant (17), Pinskdrev woodworking holding (15), Mogotext Textile Factory (10), Belshina

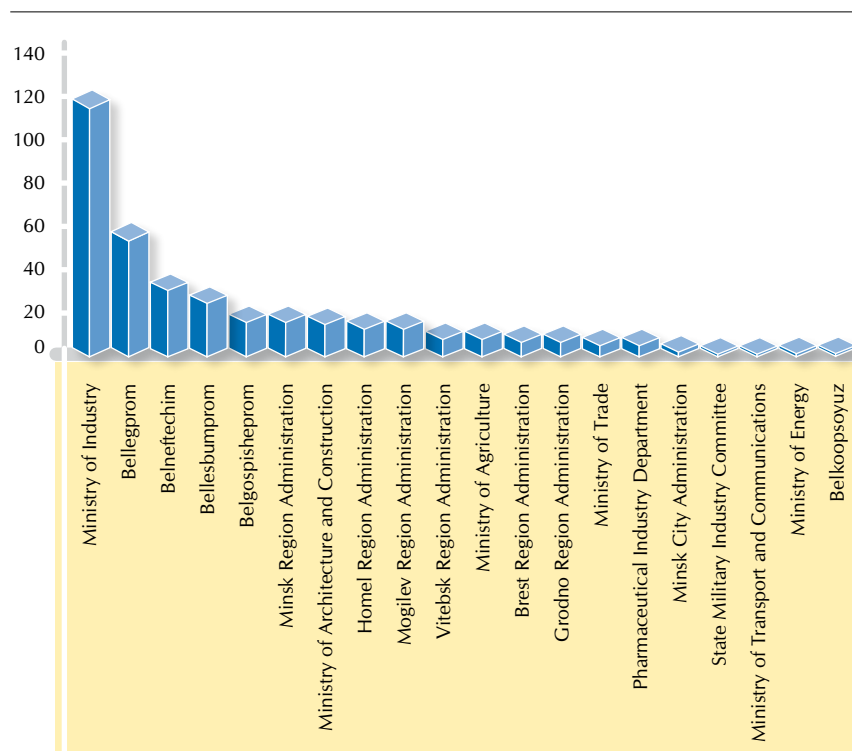


Figure 9.1.
Structure of the Belarusian Commodity Distribution Network with Belarusian Capital

Source: Belarusian Ministry of Trade web site (<http://www.mintorg.gov.by/>)

(tyre producer) (10) and Minsk Motor Plant. These figures, however, should not be misleading as CDN agents considerably vary by both scales of activities and successfulness. For example, three out of eight MMP's commodity distribution companies are in the bankruptcy process.

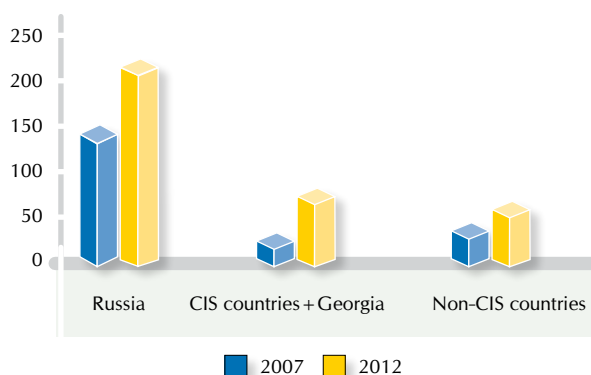
These are mainly small and medium businesses where investments hardly exceed a threshold of \$1 million.

The total number of annually established CDN companies is impressive: e.g. in 2010 only, a Bellegprom's network increased with new 36 dealership and distribution companies and 3 trading houses. However, small firms with minor investments hardly exceeding several thousands of dollars prevail among CDN companies in Russia. This is pretty aligned with the overall economic strategy of Belarusian companies, which prefer not to place production facilities abroad, but instead manufacture in the home country and create most favourable conditions for promoting commodities abroad, which does not require serious investments. The only relatively large CDN investment was made by the Minsk Tractor Plant, which invested in the creation of 6 trading houses in Russia, which are joint ventures with controlling interest owned by the plant.

The world economic crisis which started in 2008 actually accelerated, rather than slowed down, the expansion process of the Belarusian CDN. However, the CDN geography has somewhat changed. The reducing trade with Russia made Belarusian exporters to look at other markets and in 2009-2012 the number of commodity distribution companies was mainly increasing in other CIS countries and Georgia. In mid-2007, Russia accounted for 73% of the total number of CDN companies with Belarusian investments and 86% of the CDN companies located in the CIS countries, whereas at the end of 2012, these percentages were 63% and 74% respectively. The percentage of commodity distribution companies operating in non-CIS countries almost unchanged (15% in 2007 and 16% in 2012).

Figure 9.2.
Numbers of CDN
companies with
Belarusian capital

Source: Prepared by
author based on the
data of the Belarusian
Ministry of Trade
(<http://www.mintorg.gov.by/>)



An emerging trend is to create multifunctional trading houses offering products of a wide range of companies in the countries where Belarusian producers have no firm positions and have an objective to develop a new market (e.g. in Turkmenistan and Armenia).

Belarusian investments go beyond investments into commercial CDN (though this was a prevailing trend since mid 2000s). In addition to promoting their own distributing networks, Belarusian companies (first and foremost, machine building ones, such as BelAZ and the above mentioned MTP) establish assembly operations, typically based on existing facilities. Thus, in 2010 BelAZ set up a joint venture in Korkino (Chelyabinsk Region) with Korkin Excavator and Car Repair Plant, where a new assembly line was launched. Already in mid 2000s, Homselmash (a BelAZ structure) started assembling know-down kits manufactured in Byelorussia through a joint venture with Bryanskselmash. Final assembly from the ready components at the Russian plants does not require large investments: the investments in each of the above cases were below \$1 million. Thus, 31 assembly operations were set up in 2010 in Russia,

however, these are mostly small businesses as their consolidated revenues were about \$100 million, i.e. on average, \$3 million for each. There was no demand in Russia for the produce of some assembly facilities and the assembly operations were curtailed. This was the case with assembling of Belarusian tractors at Spetstechnika (Rubtsovsk, Altai Region) and RosBelTractor (St.Petesburg) facilities. This demonstrates poor knowledge of Russian reality by Belarusian enterprises.

BELARUS AS A BRAND

The success of Belarusian producers at the CIS markets is strongly related to the positive perception of Belarusian products in the neighbouring countries inherited from the Soviet Union time. Belarusian goods are associated with fairly high quality and reasonable prices. 'Made in Byelorussia' label is a guarantee of quality for a wide range goods, including food, light industry products, cosmetics, etc. In many ways this is explained by deliberate public policies. The Republic of Belarus is the only CIS state, and this is continuously mentioned on official Web sites and in Belarusian companies' advertisements, which meets old Soviet time State Standards (GOST), and in some cases these have been made even more stringent. To sustain their positive image, commodity distribution agents of the companies which have a habit and reputе abroad emphasize, in every way, their Belarusian origin, thus working for the country's image.

In the past decade Russia and Ukraine (and other CIS countries in a less degree) saw the establishment of many trading companies which sell Belarusian goods and use the word 'Belarusian' as a brand: 'Belarusian Wallpaper', 'Belarusian Products', 'Belarusian Tinned Food', etc. (Topolko, 2012). In some cases CDN agents established in Russia sell goods produced by several Belarusian companies. The most striking instance is the Belarusian Sugar Company which successfully sells the produce of four sugar plants.

At the same time there is an increasing number of commodity distribution agents with no Belarusian investments but using, for marketing purposes, the word 'Belarusian' or other words with clear associations with the Republic of Belarus. As of end 2012, over ten trading houses were registered in Russia only which names contained the word 'Belarusian', only three of which (see Table) have Belarusian investments. It is notable that many stores though they refer to their Belarusian origin, in fact, sell goods from different countries. For example, Belarusian Furniture, a store chain in Moscow, sells, apart from Belarusian products, furniture made in Russia and China.

Thus, using the country brand is an essential part of Belarusian producers' competitive strategy. It is important to realise that brand recognition of specific Belarusian companies which produce consumer products remains low (one of a few exclusions is Milavitsa, a lingerie producer, which has popular trademarks

outside Belarus). This strategy has both advantages (a possibility for export market penetration by little-known companies), and disadvantages. Belarus as a brand has firm positions only in the former Soviet countries, whereas in non-CIS countries, the Belarusian origin can hardly be a motivating factor for a product choice. Yaroslav Romanchuk, a well-known economist and Belarusian oppositionist, rightly noted that Belarus, as a brand, does not practically exist beyond CIS (Romanchuk, 2012), which is explained by the negative reputation of the Belarusian administration and lack of deliberate policies to improve the country's image in the West. Those companies which have commodity distribution agents in non-CIS countries (mainly these are heavy industry producers like BELAZ, MTP and BMP), have therefore to stress other advantages, first and foremost, lower prices as compared to their competitors. One can

Table 9.1.
CDN agents
in Russia using
'Belarusian'
in their names

CDN agents with Belarusian investments	Parent Company	Place of incorporation	Supplied products
Belkonditer LLC	Spartac, Communarka, Krasnyi Mozyryanin, Slodych and Vitba confectioneries	Moscow	Confectionery
BelarusAlco LLC	Homel Distillery, etc.	Moscow	Alcoholic beverage
Belarusian Sugar Company LLC	Gorodei, Skidel, Slutsk and Zhabinka sugar plants	Moscow	Sugar
Belarusian Food Company LLC	Belgospisheprom	Moscow	Salt, tinned meat, fruits and vegetables
Belarusian Present Trading House	Belgospisheprom	St. Petersburg	Brewery products
Belarusian-Northwestern Food Trading Company LLC	Belgospisheprom	St. Petersburg	Potato and vegetables, tinned fruits and vegetables
Northwestern Russian- Belarusian Trading House	Belgospisheprom	St. Petersburg	Dairy and meat products
Belarusian Flax – Ivanovo LLC	Olshansk Flax Processing Plant	Ivanov region	Linen and half-linen fabric, bed and table clothes
Belarusian Housebuilding LLC	Newsprint fibres plant	Moscow, St. Petersburg	Wooden houses
Belarusian Furniture	K-Mebel Studio, Yavid, Pinskiy, Molodechnomebel, Viley furniture plant and Homeldrev	St. Petersburg	Furniture
Belarusian-Ural Company	Belshina	Chelyabinsk region	Tyres and covers
Belarusian Food Trading House	Homel Region Administration	Moscow region	Sausage goods, tinned meat, prepared food, by-products
Belarus-Inmash JV	Minsk Tractor Plant	Republic of Bashkortostan	Belarus-320.4 tractors and spare parts
Belarus-South LLC	Minsk Tractor Plant	Rostov region	Belarus-320.4 tractors and spare parts

say the same about the companies working in innovation area, particularly, information and communication technologies. Thus, Wargaming.net, a private Belarusian firm which has become a recognized leader at the online games market and has offices in many countries over the world (US, France, Germany, Cyprus, South Korea, Australia and Singapore), prefers not to mention at all its Belarusian origin in its marketing campaign beyond the CIS countries.

CDN DEVELOPMENT PROSPECTS

The official data on CDN development trends demonstrates its continuous expansion, both quantitative (increasing number of CDN agents), and qualitative (increasing sales and share of CDN-driven exports). However, if we compare current values vs. targets, then the picture becomes quite ambiguous. The government's objective to export, by 2010, 80% of all products through the commodity distribution network was not achieved. However, some companies managed to achieve considerable progress. Thus, Belshina, which is often cited as an example of successful CDN expansion, currently sells 60% of its products through CDN. But food and light industry enterprises have much lower achievements and most produce is still sold through foreign dealers.

In November 2012, Belarusian President Alexander Lukashenko frankly recognised CDN's poor efficiency stating that 'less than 10% of Belarusian exports are sold through own networks but even these entities have poor financial discipline and lack sound pricing policy (Byelarusian News, 2012). The head of the state also stated that Belarusian products (including manufactured by MTP) are often sold at export markets bypassing own networks, for example, such products are supplied to dealers at domestic market prices as though to be sold in Byelorussia, but in reality are exported. But one more issue should be also noted, and the government does not always take it into account: many CDN agents with Belarusian investment exist on paper only or, having failed to secure profitability of sales, are on the verge of bankruptcy. The review of CDN in 2012 revealed that, at least, 15 out of 214 legal entities incorporated in Russia are not operational (in practice, the number of such 'deadborn' companies is higher because necessary data was not gathered about all companies). However, in other CIS countries where CDN promotion was started relatively recently, this number is noticeably lower which bears evidence of more cautious government actions for this type of export promotion.

The issues faced by the Belarusian CDN in its development are direct consequences of a planned nature of the economic system that has emerged in the country. Poor efficiency of some commodity distribution companies results from the fact that the decisions to establish such companies are often made without due consideration of the existing market trends and are initiated by officials of the Ministry of Trade who are not always competent in this matter and can be motivated by noneconomic considerations (e.g. desire to

report large numbers of new CDN agents). There are also known cases when Belarusian producers which already had quite efficient sales schemes had to give up those and supply their produce to the newly established trading houses which adversely affected their returns from sales. Those who criticise the system emphasise that the CDN serves more the purpose of commodity distribution rather than commodity promotion abroad (Director, 2006). Therefore the Belarusian CDN needs to improve the marketing component of its activities and to pursue more proactive policies to gain in foreign markets.

The Belarusian authorities tend to believe that CDN's deficiencies are not systemic and can be rectified by additional administrative measures, for instances, by establishing a new regulatory authority, standing Export Promotion and CDN Enhancement Commission chaired by the Belarusian Prime Minister. A possible solution to the existing issues can be to enhanced efficiency of the existing CDN agents, particularly, through the initiation of more flexible marketing arrangements (sale on credit or installment sale); these will help to solve the problem of overstocking faced recently by many companies with Belarusian investments. Another area of efforts can be the development of new directions of trade expansion. Even now Belarusian enterprises are actively trying to develop CIS markets, particularly, penetrating Central Asian and Transcaucasian markets. But even in Russia there are still many opportunities for CDN expansion, especially in the regions where Belarusian products are almost non-present (over a half of CDN agents with Belarusian investments operating in Russia are registered in four constituent entities of the Russian Federation: Moscow city, St.Petersburg, Moscow and Smolensk regions).

Although the process of commodity distribution network development is facing apparent difficulties and CDN agents sometimes fail short of expectations, no other options for promoting Belarusian exports are currently noticeable. As long as most exported products are produced by state-owned (or quasi-public) entities the course for CDN expansion will most likely be continued.

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10

Energy Security and Water Resources Management in Transboundary River Basins in Central Asia

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Central Asia (CA) has sufficient fuel and energy resources to allow the countries not only provide for their own energy needs, but also to cater for foreign markets as well. There are considerable reserves of energy resources, although these vary significantly in their value and type among the states in the region. Kazakhstan, for example, has large reserves of oil, gas, coal, and uranium, many times larger than the potential hydropower resources in the country. Uzbekistan

also belongs in the category of countries with, oil, coal and uranium, but its hydropower resources are assessed as moderate. Turkmenistan has some of the world’s largest gas fields, but almost no hydropower resources. Stockpiles and the distribution of primary energy resources determine the structure of the fuel and energy balance of governments. CA is considered not just as a region with some of the world’s largest oil and gas reserves, but it also has possesses of the most important transportation lines. One of the main gas pipelines, Central Asia-Centre (CAC), that allows Uzbek and Turkmen gas to be delivered to Russia, Ukraine, and the Caucasus is routed through Kazakhstan. Uzbekistan is a transit country for Turkmen gas and Kazakhstan – for Uzbek gas. Regional gas transport infrastructure was created during the Soviet period and gas transport routes out of CA are largely set up in a centralised system to supply fuel to European countries. Four lines from the main gas pipeline run from Turkmenistan through Uzbekistan (and further through Kazakhstan), and one line runs along the coast of the Caspian Sea through Kazakhstan. There are also additional branches of the CAC, from which two are highlighted: between Turkmenistan and Kazakhstan and between Kazakhstan and the Russian Caucasus. Two lines from the Bukhara – Ural gas pipeline begin in Uzbekistan near the city of Gazli (Bukhara Province), cross Karakalpakstan (Uzbekistan) and then proceed through Kazakhstan to the Southern Urals. In addition, there are two other gas pipelines that cross Kazakhstan (Orenburg – Novoposkov and Soyuz), which transport gas from Siberian reservoirs to Europe. New oil and gas routes from Central Asia are being formed in a competitive global energy market and with the growing influence of world powers on the region (ISSA, 2010: 28-61). In the structure of primary energy resources, gas, coal and oil occupy a special place in CA. 81% of total production and 83.5% of energy resource consumption happen in Kazakhstan and Uzbekistan. If Kazakhstan is the largest producer of primary energy resources, then according to demographic factors, Uzbekistan is a leader in their consumption. Kyrgyzstan and Tajikistan have great potential for hydropower resources, but they do not have sufficient reserves of hydrocarbons, which determine the development of energy in these countries, based on the use of hydropower resources.

	Installed Capacity (MW)					
	TPP	%	HPP	%	Total	%
Kazakhstan	17,252.4	86.7	2,639.7	13.3	19,892.1	100
Kyrgyzstan	716	18.9	3,070	81.1	3,786	100
Tajikistan	318	5.8	5,121	94.2	5,439	100
Turkmenistan	4,536	99.8	9	0.2	4,545	100
Uzbekistan	10,643	85.5	1,810.7	14.5	12,453.7	100
Subtotal for CA	33,441.4	73.2	12,259.7	26.8	45,701.1	100

Table 10.1.
Structure of CA
Power Plants’
Installed Capacity

Source: WB, 2010;
 CASA, 2011;
 Data from
 government
 bodies of energy
 management
 of CA countries.

Note: as of
 01.01.2012

The total installed power generating capacity of Kazakhstan is 19,892.1: 17,252.4 MW from thermal power plants (TPP) (86.7%) and 2,639.7 MW from hydropower plants (HPP) (13.3%), including small HPP and other renewable energy resources. 70% of the total volume of electricity is generated by local coal. There are gas turbine power plants operating in the west and south of the country. Kazakhstan is facing a deficit of electricity, which is covered by Russia's balancing market. The reduction and subsequent elimination of the deficit is planned and will be carried out by constructing new power plants and modernising existing ones. Electricity production in 2010 reached 82.26 billion kWh.

The electric power system in Kyrgyzstan works in parallel with the Central Asian power grid and is supported mainly by hydropower facilities (3070 MW, 81.1%), which provide additional energy in summer and cover the periods of peak load by the Central Asian Unified Energy System (CA UES). Thermal power plants (716 MW, 18.9%) are designated for the increased load during winter. Hydropower plants are located mostly in the Naryn river cascade in the southern part of the country. Electricity production in 2010 was 12.06 billion kWh. Kyrgyzstan has the ability to export up to 2.5 billion kWh of electricity during the periods of high irrigation releases from the Naryn HPP cascade. The total installed capacity of power stations in Tajikistan is 5,439 MW: 5,121 MW are from HPP (94.2%) and 318 MW from TPP (5.6%). Hydropower plants are mainly located on the Vakhsh cascade in the southern part of the country, with the generating capacity of the HPP in the northern region being only 126 MW.

The annual production volume cannot meet the demand for electricity in the winter. From the beginning of October to the end of April, there is a deficit of electricity of about 4 billion kWh. In the winter, Tajikistan is forced to limit the demand for electricity. In the summer, the country has a surplus of electricity, the volume of which depends on the amount of water released from the reservoir and the hydrological conditions that year. In 2010, electricity produced from Tajikistan's HPP exceeded 16.4 billion kWh with its highest excess in recent years at 4.5 billion kWh. As Tajikistan has been shut off from the main CA UES network, it cannot export electricity outside the country and for this reason is facing great economic losses. Turkmenistan's generating capacities is most in its TPP, which use natural gas as the primary fossil fuel. The total installed capacity of Turkmenistan's power system is 4,525 MW: 4,536 MW is from TPP (99.8%) and 9 MW comes from HPP (0.2%) Turkmenistan has a surplus generating capacity for electricity. Electricity production has reached 10.5 billion kWh and greatly exceeds the demand for it, which allows electricity to be supplied to other countries.

Prior to Turkmenistan leaving the CA UES in 2003, excess electricity was 50% and its main importers were Kazakhstan and Tajikistan. As there was no transit

agreement with Uzbekistan, Turkmenistan had to leave the CA UES. Currently, electricity exports of 2.6 billion kWh go from Turkmenistan to Afghanistan, Iran, and Turkey. According to Turkmenistan’s Strategy for Economic Development to 2020, electricity production will reach 26.4 billion kWh a year with 6 billion kWh exported annually. Uzbekistan’s power system, which is geographically situated in the centre of the unified energy system and has about 50% of the CA UES total capacity, plays an important role in ensuring a reliable power supply to consumers in the region by facilitating the transit flow of electricity exports to other countries. Uzbekistan’s power system has an installed capacity of more than 12,453.7: 10,643 MW from TPP (85.5%) and 1,810.7 MW from HPP (14.5%).

Electricity production in Uzbekistan in 2010 was 51.7 billion kWh a year. Almost the entire amount of electricity in Uzbekistan is produced by thermal power stations that use natural gas as the primary fuel. As operating thermal power stations are more effective in their base-load regime, regulating capacity in terms of the lack of hydropower potential is a rather serious challenge for the country’s power grid. It is worth mentioning the seasonal nature of the import and export of electricity: Uzbekistan imports electricity from Kyrgyzstan and Tajikistan in the summer and delivers it in the winter to various regions of northern Tajikistan based on bilateral agreements between the countries. Uzbekistan also exports electricity to Afghanistan. Of all the hydropower plants in Uzbekistan, only the Charvak HS (620 MW) and the Khodzhikent HPP (150 MW) can provide regulation, but the required capacity is more than 2,500 MW. The economically and technologically appropriate solution to the problem of regulating frequency and capacity is the use of advanced interstate power lines with neighbouring countries that have significant hydropower potential, such as Kyrgyzstan and Tajikistan. The demand for electricity in the CA countries is predicted to grow annually until 2030 at a rate of 1.6–2.6%. One thing the CA countries have in common is a high wear of power station equipment of all types and power lines, which together contribute to a large loss of primary energy resources and produced electricity. Therefore one of the priorities for investment policy in the CA electricity sector should be to implement measures to reduce the technical loss of electricity and modernise the existing generating stations. By reducing the technical losses of electricity and modernising and upgrading generating facilities, the bulk of the forecasted demand in CA could be covered.

Bringing new generating capacity online necessary for planned socio-economic development could also be considered as an investment priority. Central Asia’s hydropower potential was valued as early as the beginning of the 19th century. Deutsche Wasserwirtschaftskräfte printed an article titled “The Earth’s Water Power” which gave a brief inventory of the world’s water resources including an overview of hydropower reserves in the then USSR. The numbers bear witness to the fact that Central Asia has the richest reserves of water energy (after the

Caucasus) in the then USSR. From these numbers, it follows that Central Asia occupied first place in the USSR in terms of quantity and total capacity of the largest water energy resources (Davydov, 1925: 91-93). A current assessment of Central Asia's hydropower potential is presented in *Table 10.2*.

Countries	Hydropower Resources (potential, billion kWh annually)							
	Gross		Technical		Economical		Utilized	
	Total	share in CA (%)	Total	share in CA (%)	Total	share in CA (%)	Total	share in CA (%)
Kazakhstan	170	15.8	30	6.3	23.5	5.71	9	17.7
Kyrgyzstan	249	23.1	99	20.9	55	13.3	14	27.6
Tajikistan	527	48.9	317	67.1	317	76.86	19.5	38.4
Turkmenistan	24	2.2	5.8	1.2	2	0.48	0.1	0.18
Uzbekistan	107	10	21.1	4.5	15	3.65	8.2	16.12
Total	1077	100	472.9	100	412.5	100	50.8	100

Table 10.2.
Central Asian
Hydropower
Resources

Note: 1. Gross hydropower potential: energy equivalent of hydropower energy reserves concentrated in sources of potential hydropower at full usage; 2. Technical hydropower potential: part of the gross hydropower potential that can be used by modern technology to meet requirements of a socio-environmental nature; 3. Economic potential of hydropower: part of the technical hydropower potential whose use under current conditions is economically effective to meet requirements of a socio-environmental nature; 4. utilised potential of hydropower: hydropower that is used

Source: UNESCO,
2010; Molodtsov,
2010

The total gross hydropower potential of Kazakhstan is theoretically 170 billion kWh a year, of which 27-30 billion kWh is cost effective and viable for use. Accounting for the changing river water levels, the gross energy potential in Kyrgyzstan from 268 rivers (linear accounting), 97 of the largest canals, and 18 reservoirs studied is 249 billion kWh of electricity produced a year at average water levels. 99 billion kWh a year are economically justified for utilisation (<http://www.caresd.net>). Tajikistan has significant hydropower resources. An assessment of their reserves, based on direct observations of 530 (from a total of 947) rivers in the country and on primary data from the Hydrometeorological Service, shows that the gross hydropower potential is 527 billion kWh, while technical potential – also accepted as economic – is more than 317 billion kWh a year (RT, 2007: 29-31). Turkmenistan has no hydropower resources that are sufficient for use with the goal of regulating the country's power capacity. Nonetheless, Turkmenistan has had experience in making use of rivers hydropower. The oldest hydropower plant in the CIS – the Hindu Kush HPP – is located here. At the end of the 19 – beginning of the 20th centuries, three dams were built on the Murghab River (Turkmenistan) for irrigation: the Yoloten, Syltanbent and the Hindu Kush, the last two of which had hydropower plants constructed on them.

The Murghab River is a transboundary river that originates in Afghanistan. The Hindu Kush HPP was the largest power station in pre-revolutionary Russia. There are three hydro turbines installed in the power plant with a total capacity of 1.35 MW. Power equipment was supplied by the Austro-Hungarian company Hans. Celebrating its 100th anniversary, the Hindu Kush HSP is still in operation, annually producing on average 0.8-0.9 million kWh of electricity. Potential hydropower resources in Uzbekistan have been adequately studied and compared to other forms of renewable energy resources. The gross potential of 656 rivers and their tributaries is 107 billion kWh a year. Uzbekistan's hydropower resources were estimated taking into account the potential of both large and small rivers; existing, under construction and project reservoirs,

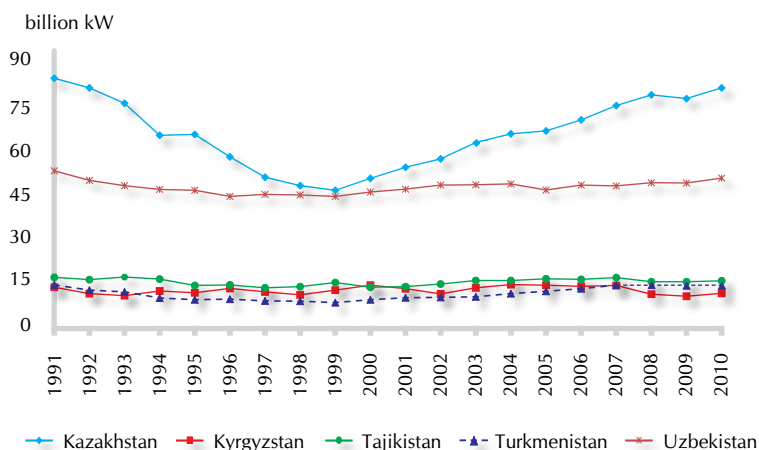


Figure 10.1.
 Dynamics
 of electricity
 Production
 in Central Asian
 Countries

Source: CIS ISC

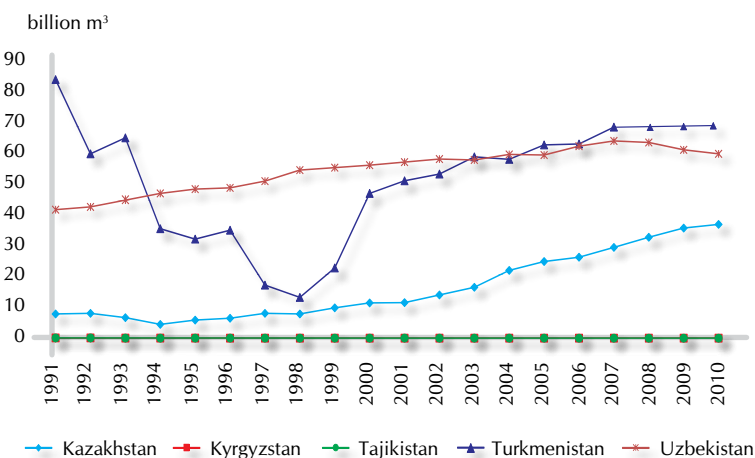


Figure 10.2.
 Natural Gas
 Production

Source: CIS ISC

master irrigation canals and main trunk canals with a discharge between 50-158 m³/s and which have a possible drop of 2 to 120 m. The technical potential of hydropower resources is estimated at 21.1 billion kWh a year.

Figure 10.3.
Oil Drilling,
including Gas
Condensate

Source: CIS ISC

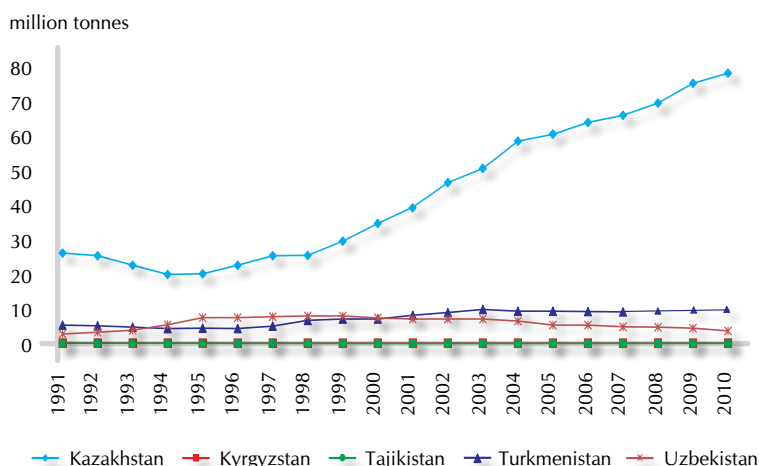
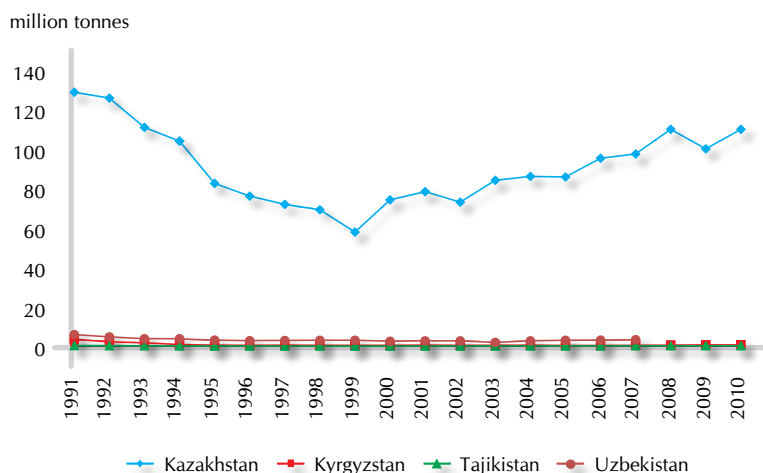


Figure 10.4.
Coal Mining
(million tonnes)

Source: CIS ISC



The geographical distribution of primary fuel and energy resources objectively stipulates the structure of the Central Asian states' generating capacity as well as the need for and feasibility of regional energy integration on the basis of exchange (export-import) of electricity and various other forms of energy. During the Soviet time, accounting for the territorial particularities, Central Asia saw the creation of a fuel and energy complex that had a high level of regional

integration. The unified energy system of Central Asia provided a stable mode of operation, reliable interstate supply of hydro resources and a water use regime that was regulated by the hydropower plants in the region.

The CA UES, including the power systems of Uzbekistan, the southern regions of Kazakhstan, Kyrgyzstan, Tajikistan, and Turkmenistan was designed based on unified criteria for the system to operate at the lowest cost. The regional electricity infrastructure of CA, which in turn was part of the UES of the USSR, was built to be an integrated system, optimally using the available fuel, energy and hydropower resources in the region. The CA UES is a set of electricity facilities, exploitable resources, and their management, linked by a single process of electricity production, transmission and distribution. One of its more important advantages was the ability of the participating states' electricity systems to operate in parallel to one another – i.e. electricity systems working together on a common frequency. The parallel operation of electricity systems is a prerequisite for reliable operation and creates the basis for mutually beneficial cooperation in the electricity industry. The main principles of parallel operating power systems are:

- satisfy the demand for electricity and capacity in each power system at all times through either their own power stations or energy delivered from other states on a contractual basis;
- maintain the standard frequency within the agreed range in every power system through either its own sources of energy and/or through crossflows from power systems in other states; and
- maintain the required reserves in every power system and supply the missing amount of reserve on a contractual basis from the power systems of other countries.

After the collapse of the USSR, in order to maintain parallel operations, the CA countries signed an agreement in 1998 on the parallel operation of the energy system. All technical issues for the operation of the existing 500 kW network and the 220 kW power lines were placed under the control of the Coordinating Council of CA UES. It consists of the national operators of the generation, transmission and distribution systems: Kazakhstan: JSC KEGOC – network operator; Uzbekistan: State JSC UzbekEnergo – vertically integrated state energy company for production, transmission, and distribution; Tajikistan: JSC Barki Tochik – vertically integrated state energy company for production, transmission, and distribution; Kyrgyzstan: JSC NESK – network operator; JSC Power Plants – generation; Turkmenistan: State Corporation Kuvvat – vertically integrated state energy company for production, transmission, and distribution; The Coordinating Council of the CA UES established Energy, a Coordination Dispatch Centre (CDC), located in Tashkent and functioning as the first hierarchical level of the power system's dispatch of Central Asia. The

role of second level dispatch centres in the CA countries is filled by separate organisations that are involved in the dispatch of the national power system. CDC Energy is funded on the principle of shared costs between the parties involved. As a regional system operator, CDC Energy shall ensure compliance with the principles of parallel operation and operational coordination based on the information received daily from the national dispatch centres. These centres make use of instructions and recommendations from CDC Energy. However, not all countries in the region support joint operation, which greatly reduces the opportunities for regional energy security and interstate water use in the transboundary river basins. Uzbekistan has limited its participation in parallel operations and the power systems of Tajikistan and Turkmenistan function in isolation from the CA UES.

Moreover, Turkmenistan's power system has changed in configuration and in order to restore the technical parameters and lines connecting it to the other countries in the region, significant investment is needed. The economic losses from isolated power system operations are considerable. As a result of a fragmented CA UES and its unstable parallel operations, CDC Energy is not fully exercising its functions. Instead, it has been reduced to mostly monitoring capacities (the flow and production from large hydro and thermal power stations, and the demand for electricity in the separate units); the operating of automatic load-frequency control, the distribution of delivered and needed amounts of electricity for balancing; and to providing analytical and advisory services.

The effectiveness of the CA's power system control mechanism and the corresponding HPP operations have fallen sharply with the loss of its regulatory functions as a result of the trend of national power systems leaving this system. The bulk of electricity exports and imports between countries in the region are maintained in the summer when water releases from reservoirs are necessary for irrigation needs in Uzbekistan and Kazakhstan. But this regime is fraught with difficulty because of the abeyance of mutual commitments and the conditions of fulfilling them. The volume of regional electricity trade has decreased from 25 GWh in 1990 to 3.7 GWh in 2008. As noted in the "Analysis of energy management and the reciprocal exchange of energy between nation power systems in the Central Asian region" (WB, 2010), Kyrgyzstan, Tajikistan, Uzbekistan and Southern Kazakhstan can fulfil their own electricity needs, but in order to do so, energy systems working in parallel is a necessity.

This same study also emphasises that CA countries are trying to increase their energy independence and grow their export capabilities beyond the region, and, not having sufficient funds to upgrade their energy infrastructure, are reducing the amount of regional energy cooperation. Achieving the criteria for a reliable, national power system is only possible through a unified power system. The results of a SWOT analysis and a simulation of the CA power systems within this research shows the significant benefits of the CA power systems working

in parallel, one of which is an increase in the reliability of the supply. The simulation results show that through parallel operation of CA power systems, it is possible to save more than \$1.6 billion in the first three years of a fully-functioning unified system. Given that losses due to an undersupply of electricity by users reached no less than \$200 for 1 MW, a stable and operational power system can have a positive economic effect of more than \$0.5 billion. Thus, in the first stage of transition of CA power systems to this mode of operation, expected savings will exceed \$2.1 billion. In general, the benefits of a unified power system outweigh any possible shortcomings.

Strengths	Weaknesses
Optimal use of natural resources. Optimal scheduling. Efficient use of thermal generation. Decrease in necessity of investments. Use of advanced regional network. Reduction in undersupplies of energy. Improved reliability of supply. Decrease in the need for secondary reserves.	Potential risk of violation of agreements by other participants. Potential risk of emergency situations in neighbouring countries (which are compensated by the ability of neighbouring countries to offer support). Lapse in energy supply, leading to social and economic harm.
Opportunities	Threats
Ability to resolve: Issues of electricity and water resources (complex solutions). Issues with transit and customs duties. Issues related to import-export of electricity. More incentives and better conditions for the development of projects that are regional in scale.	Issues of national energy security, primarily, the independence from external energy resources. Could lose priority access.

Table 10.3.
Results of the
SWOT Analysis for
the United Energy
System

Source: WB, 2010

The UES is beneficial to all participants from both a technical and an economic viewpoint. The current economic atmosphere is forcing every country to exercise its own energy policy, often conflicting with the prospects for the development of a regional power framework. In the structure of Kyrgyzstan's generating capacity, for example, 81.1% is from hydropower and 18.9% from thermal power and in Tajikistan hydropower accounts for 94.2% and thermal for just 5.8%. With a limited transit flow of electricity among the CA UES, this type of generating capacity ratio makes energy supply in winter difficult for these countries. They are therefore considering and implementing plans to bring new HPP generating capacities online. However these solutions do not fully take into account their impact on the short-term energy security and interstate water use for the whole region. Energy development is seen more from the position of being able to export the excess capacities outside the CA borders without sufficient regard for their own and regional needs in the future. Forecasts show that Central Asia is expecting an increased need for electricity between 2020–2050 due to the dynamics of economic development and population growth.

This period coincides with the forecast of climate change and a stable reduction in water levels in the Syr Darya and Amu Darya basins. With insufficient accumulation in the reservoirs, drawdown for electricity needs could lead not only to a reduction in the electricity produced but to a deficit of water during the growing season, the loss of the long-term regulation of reservoir, capacity and worsening conditions in interstate water management. As international practice shows, the attitude of the individual countries in CA in developing hydropower alone does not provide a proper measure of energy and water security for the region. It is therefore necessary for all the Central Asian republics to diversify energy their sources and ensure reliable electric power. Coal could play an important role in raising the sustainability of the energy supply and combating the rise of regional power imbalances.

Creating transportation corridors for the delivery of coal to thermal stations, adopting preferential tariff regimes for this type of energy, and the use of clean coal technologies will enhance its competitiveness in comparison to other types of fuel and ensure a reliable energy supply. The production of energy from renewable sources such as the wind or sun or from the use of small hydropower plants is still quite expensive, but these sometimes present the cheapest means of providing electricity to rural populations. It is necessary to quickly develop new and effective technologies for the use of renewable sources of energy. However, the most reliable and guaranteed source for cities and major settlements is still coal. In general, the region is considered to have an overabundance of coal, allowing for a wider scope of coal use in building new TPP. Incidentally, this is a worldwide trend: according to forecasts, by 2025 coal will provide 31% of the world's electricity.

By 2025, coal will account for 50% of the total energy production in the US. China's use of coal in electricity generation will increase from 72% in 2001 to 73% by 2025. Coal is a flexible source of energy and although today it is mainly used for electricity production, it can also be processed into synthetic gasoline, diesel, hydrogen or other types of transport fuel. New technologies mean that there is also the potential for coal to reduce oil consumption. Kazakhstan is one of the large coal-mining countries of Central Asia (3.5% of the world's coal reserves). The presence of large reserves and the reliability of the supply could help eliminate in a relatively short time the disparities in the generating capacity structure in Kyrgyzstan and Tajikistan, thereby increasing their energy security.

Energy production using coal is also competitive in terms of price. To overcome the negative environmental effects of using coal will require the development of new technologies and applying them on an industrial scale. Upgrading of existing facilities and the construction of new facilities using modern technologies that increase the efficiency ratio will make a positive difference in the volume of emissions and control in greenhouses gas emissions. Another promising source

of electricity in the region is uranium. 17% of the world’s reserves are located in Central Asia with Kazakhstan and Uzbekistan being among the top ten reserves of uranium and in possession of advanced technologies for its extraction. Kazakhstan has 1.6 million tonnes of proven uranium reserves, which makes it second in the world. With its common geological position, historical traits and territorial remoteness, Kazakhstan can be viewed as having six uranium provinces: Shu-Sarysui, Syr Darya, North Kazakhstan, Caspian, Balkhash and Ili (kazatomprom.kz).

Uzbekistan is seventh in the world in uranium reserves and fifth in its extraction. Uranium mining and processing also takes place in Kyrgyzstan and Tajikistan and the prospects for a nuclear industry are tied to the development of earlier-proven ore deposits. States in the region that have sufficient reserves of uranium and a nuclear industrial complex can cooperate in the development of nuclear energy. It should be noted that as a result of the prolonged and intensive mining and processing of uranium ore, the region has accumulated a large amount of radioactive waste stored in tailing ponds. Many of these are located near tributaries of the transboundary rivers. Because of the unsatisfactory state of the tailing ponds, they present a threat to the public and the environment and in the event of an accident, the waste may fall into the rivers and spread over large distances. Tailing ponds are in need of major repairs and preventative measures need to be taken to prevent the release of radioactive substances into surface and ground water.

The problem is regional in nature and the CA countries could work together to develop programmes and implement practical actions to dispose of tailings and waste (Ibragimov, 2010: 77-104). Kazakhstan, Uzbekistan and Turkmenistan have significant natural resources (Tajikistan and Kyrgyzstan are more limited in this regard): oil, gas, gold, and other minerals. All these countries have well-developed infrastructure, human resources, and each has the potential to implement their planned social projects. The global situation in terms of raw minerals, especially energy, is also conducive to economic development in the region.

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Grain Sector: Potential of Eurasian Integration and Objectives of Economic Policy

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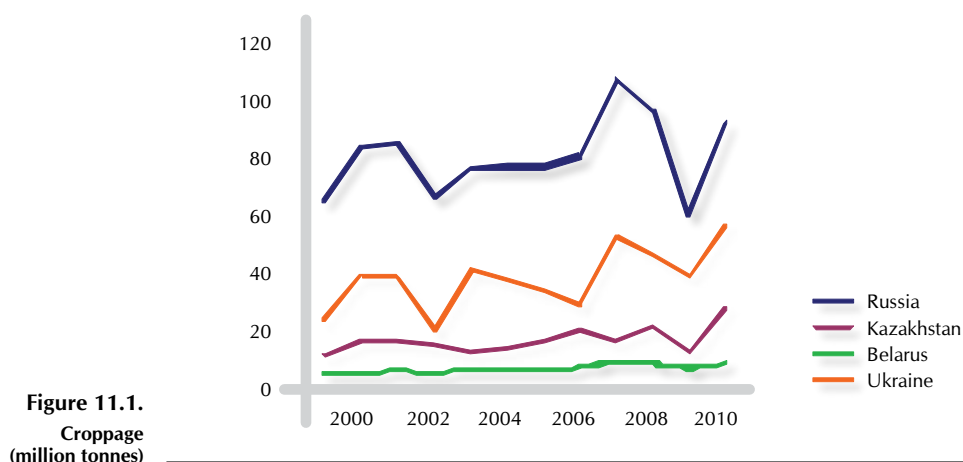
Agricultural sector of the economy of the SES countries occupies a relatively small place in the formation of national gross domestic product and total investment in fixed assets, but has critical socio-economic importance. Significant part of population of the SES countries lives in rural areas, and national agriculture is the basis of food security. The level and dynamics of the development of agricultural sector to a large extent determine growth opportunities of related sectors of production of resources for agricultural industry, processing industry and agri-food market.

Modern agricultural policy of Russia, Belarus, Kazakhstan and Ukraine is focused on the development of agriculture and increase of its efficiency. Implemented support programme have laid the investment platform of the sector, and new programme create prerequisites for sustainable development of agriculture.

A special place in the development of agriculture belongs to grain production, which historically has been the basis for the operation of the national agri-food sector, has strategic importance for other sectors of the economy of the country and serves as an indicator of economic well-being of the state.

Despite the volatility in grain production, being a consequence of climatic factors, a steady increase in yield and croppage is observed, which is the consequence of the transition to new technologies of production and management in agriculture.

In recent years, Russia, Ukraine and Kazakhstan took a strong position in the world market: the number of countries purchasing grain and flour produced by these three countries is steadily growing and exceeds 100. The share of the SES+ Ukraine in the world trade over the past five grain years amounted in average to: for barley – 36.3%, for wheat – 21.5% and for corn – 7.7%. Since 2007, Kazakhstan has been the world's leader in flour export.



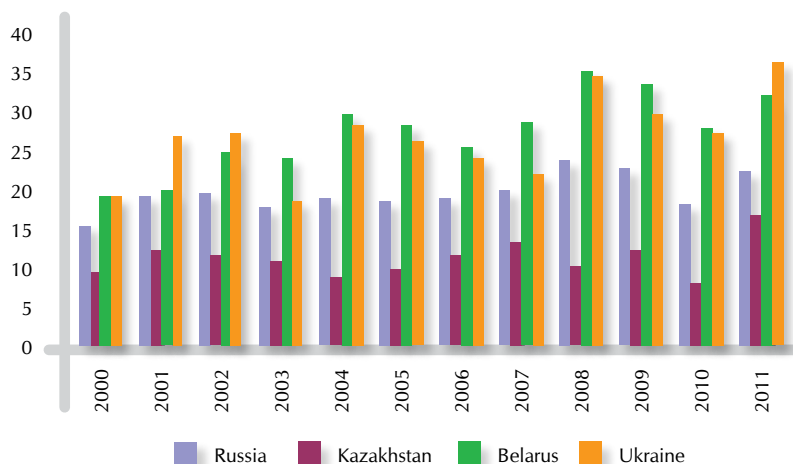


Figure 11.2.
Crop yield (100 kg
per ha of harvested
acreage)

The SES countries are the main suppliers of grain for its potential members – Moldova, Tajikistan, Uzbekistan, Armenia and Kyrgyzstan, where the area of agricultural land and grain production volumes are relatively low. These countries, except Moldova, are net importers of grain. On average, over the last few years Kazakhstan's share in wheat import by the SES + 5 countries is 77%, while Russia has 23%. Kazakh wheat is exported mainly to countries of Central Asia, and Russian wheat to Armenia.

Assessing the current state of the grain sector of the SES countries, it should be noted that in terms of gross croppage it has overcome the consequences of transformational recession of the end of 20th century: quite dynamic development is observed, the overall productivity is increasing both in crop growing and livestock production, the use of modern technologies in the food sector is expanding. At the same time, labour productivity in our country remains at a low level, the competitiveness of a large part of agricultural products, raw materials and food products in some cases is achieved through massive customs/tariff protection of the domestic market and state subsidies. Incentives to the process modernisation are obviously insufficient.

There is evidence of the growing backlog of domestic consumption from grain production in the absence of long-term incentive programme for marketing and consumption of grain and products of its processing. An artificial restraint of grain prices is observed, made in order to ensure availability of food, resulting in a loss of income of grain producers and adversely affecting their production, investment and innovation activity. Low dynamics of innovation development

can be detected, including introduction of biotechnology, technology, adapted to global climate change and demography. Infrastructure constraints of effective grain turnover are reinforcing.

In this situation, there are clear limits to growth, yield, which can lead to the stagnation after the 2016-2018, and possibilities of extensive growth through introduction of additional acreage of farmland will require significant investment and will not provide a substantial increase of competitiveness.

SES + Ukraine has unique opportunities to increase the contribution to solving the world's food problems in the presence of the world's largest cropland resources, water resources, industry for the production of fertilizers and agricultural machinery, agricultural science traditions, territorial proximity to the world regions placing increasing demand for grain. In the future, the proportion of the union in the world wheat export may rise to 25%, barley - up to 38-40%, creating a new reality, where the SES + countries act as guarantor of the stability of the world grain market.

Realisation of this potential is possible through the efficient use of agricultural resources potential and scientific and technical capabilities of each country and through achievement of synergies of coordinated measures to support and develop agri-food market of the SES countries + Ukraine, which is the evident need to form a common agricultural and food policy of the SES (CAP) and the effective economic integration on the Eurasian continent.

This presupposes an objective desirability of deeper socioeconomic integration between the SES + countries with regard to sustainable development of agriculture on the basis of mutual interest in stability and sustainability of operation of the food market. In this case, there are several hierarchic goals of common agricultural and food policy for different groups of market participants:

1. Farmers

- Achieving acceptable level of earnings and reduction of earnings volatility
- Increasing competitiveness of the agricultural sector

2. Consumers

- Ensuring food security (physical and economic availability, food security)

3. Society as a whole

- protection of the environment and biodiversity
- preservation of agricultural landscapes and recreational areas
- Ensuring viability of rural areas

Formation and practical implementation of CAP requires synchronisation of national agricultural policies, measures and instruments of state regulation on the basis of the objectives of the common agricultural and food policy of the SES and distribution of functions of national and supranational government regulation and intervention.

The effectiveness of CAP will be determined by the level of real integration of agrarian economies of member states and synchronicity of further development of market mechanisms, market-oriented, industrial and social infrastructure, mitigation of negative social and economic consequences of the current functioning of "immature" markets, rationalisation and optimisation of types of natural resources management, distribution of supranational and national regulation functions, which would require the adoption of an integrated system of international agreements on coordinated agricultural and food policy, which should complement the existing and prepared documents of the SES in terms of the specifics of agricultural sector and agri-food market.

The system of Agreements and memoranda shall coordinate and determine the following:

- Goals, objectives, principles, mechanisms, areas and tools for implementation of CAP, allocation of regulatory measures at the national and sub-national levels;
- Measures of national state support (subsidies for production and the system for alignment of competitive market conditions for the SES products)¹;
- Taxation of agricultural producers;
- Principles of foreign trade policy with respect to agricultural and food products;
- Veterinary and phytosanitary requirements based on the norms and rules of the WTO,
- Procedures and rules for operation of supervisory and control bodies;
- Methods of statistical monitoring and information exchange;
- Technical regulations and standards;
- Technical requirements for agri-food market infrastructure;
- System of coordination of activities of national institutions for the development of agri-food market, etc.

1 Today only the Agreement on common rules for state support of agricultural industry has been ratified, which imposed a limit on state support in the amount of 10% of the agricultural goods produced with respect to measures making a distorting impact on trade (for Belarus the achievement of the permitted level of support is allowed in 2016), as well as liability and compensation for exceeding the amount of support.

The adoption of the proposed system of agreements will provide for creation of a unified institutional framework for operation of national agri-food markets within the SES integration and form a basis for the development of sectoral agreements on specific sub-sectors of agriculture.

Within this institutional environment, favourable conditions are created for the formation of the common grain policy of the SES+. With that, it should be noted that there are obvious prerequisites for its implementation – high geographic concentration of interconnected companies, geographical, cultural, and institutional proximity (as a result of the integration processes). All this creates strong incentives for development for market participants, and institutional environment and governmental regulation efforts become a catalyst and initiator of development, as determinants of the global non-price competition are not so much the products, but flexible, transparent and innovative oriented environment at the level of integration space.

Grain Policy of the SES+ is a part of EAC and is designed to ensure the following:

- high rates of sustainable economic growth of the industry, balance of production development programme (in terms of volume indicators and grain crops structure), based on the requirements of sustainable development of agricultural production and optimum utilisation of production factors (competitive advantages) and the needs of domestic market of each country;
- high dynamics of integration processes and the development of mutual grain trade between the SES+ members states;
- Capacity-building for the future;
- Increased competitiveness in foreign markets and the development of grain exports of the SES+ countries;
- Creating the necessary grain reserves to ensure food security of each SES+ member state and the Community as a whole.

Its practical implementation requires the adoption of a specific sectoral Agreement, which will provide for the application of common principles of pricing and access to national markets, eliminate redundant entry barriers and create conditions for optimisation of the grain crops structure on the basis of the principle of realisation of natural competitive advantages and complementary grain production by each participant.

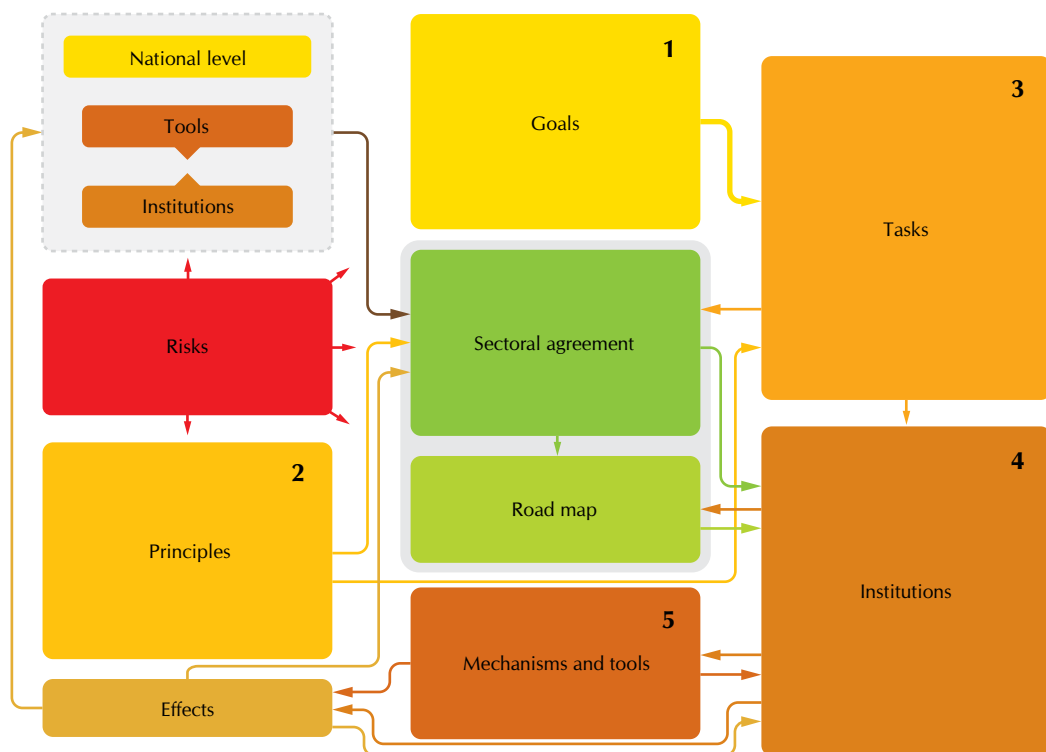
The agreement is intended to define a common paradigm for support and regulation of the whole agricultural sector, providing transition from support of under-pricing of grain for its domestic customers to measures of direct state support for efficient producers within national budgets and supranational

support system. It should be noted that state support remains the main financial lever of influence on the development of grain sector, and there are risks that each of the SES countries will attempt to support all agri-food sub-sectors individually, scattering funds and reducing their efficiency, provoking growth of unjustified mutual competition and reducing the possibility of effective export.

The agreement should define the framework approach as stimulating the formation of specialisation of each SES member based on the condition of rational use of accumulated competences and natural advantages of our countries not only to achieve a high degree of self-sufficiency, but also to improve the effectiveness of beneficial international cooperation and support grain producers in the amount sufficient to provide long-term competitiveness and balance of production and domestic consumption.

Development and implementation of the Agreement are intended to ensure synergistic effect of operation of an integrated system for stimulation of production, optimisation of the territorial structure of production on the basis of competitive advantages of the SES countries, grain exports support, covering all

Figure 11.3.
The SES+ Grain
Policy Outline



levels of government and relying on efficient mechanisms of interaction between government and business. With that, on the basis of common principles and taking into account the risks, goals and objectives shall be defined, institutions of its implementation shall be selected, and the corresponding roadmap shall be formed, which aims to provide consistency of actions to implement the Grain policy, that can be presented in the simplified scheme below.

The main objectives of development of the grain sector of the SES+ can be defined as follows:

- creation of favourable conditions for the expansion of production and bilateral trade, expansion of exports of grain and grain products (flour, etc.) in the world market, strengthening national competitiveness;
- optimisation of the national production structure based on the principle of optimal utilisation of production factors (competitive advantage) and opportunities of integration;
- reduction of price volatility and maintaining grain balance of the SES+ at the level necessary to ensure food security of each state and the Community as a whole.

The main objectives of the development of the SES+ grain market oriented at achievement of sector development goals, respectively, are:

- synchronisation of supranational and national measures and instruments of state regulation on the basis of the objectives of common agricultural and grain policy of the SES+ and objectives of maintaining income of grain producers and processors at the level sufficient for expanded reproduction and supporting liquidity of manufactured products;
- improvement of investment attractiveness and creating conditions for expanding scale and optimising the structure of production and cropland acreage, involving into the economic turnover of unused agricultural land;
- promoting mutual grain trade and ensuring equal access to the markets of all SES+ countries;
- supporting mutual investment, research, environmentally efficient technologies;
- realisation of the export potential of the SES+, which allows to take strong positions in the global grain and grain products market and maximize revenue through the use of the integration potential;
- balanced and accelerated development of grain market infrastructure on the basis of public-private partnership proceeding from the conditions for the development of SES+ grain market as a whole;

- development of scientific research intended for the use by all SES+ countries, suggesting a gradual transition to the growth of agrarian economy based not only on imported technologies, but also on creation of modern competitive technologies adapted to changing climatic conditions.

Implementation of the proposed approaches requires appropriate supranational regulatory measures, corresponding measures and tools for implementing SES+ Grain policy, which pursue the goal of stimulating accelerated transition to modern technologies of grain production and processing, introduction of biotechnology, utilisation of unused agricultural land and increasing crop yield, supporting income of grain producers and expanding markets.

Choice of objectives and tools of development of the grain sector within the framework of integration processes must take into account the maximum use of potential benefits of increase in the capacity of single market and economy of scale of production, increase of competition and improvement of terms of mutual trade, consolidating knowledge and opportunities for dissemination of cutting-edge technology.

At the same time, possible negative consequences must be offset, associated with different scales and directions of budgetary support of the SES+ countries, disparate mutual or unjustified cross-country competition. As a result, high competitiveness of the grain sector of the SES+ should be ensured as compared with goods from countries outside the integrated union. It should be noted that the modern concept of competitiveness is associated not only with the ability to sell more products and generate more profit, but also with the "intangible" aspects, such as brands, know-how.

Achieving high competitiveness is not an end in itself, but means to increase the standard of living and material well-being, i.e. it is a tool for solving the problems of rural development, as well as the guarantees of food security.

It should be noted that the logic of integration processes require changes in spatial development of the grain market, strengthening of internal and cross-sectoral cooperation ties. Efficient agricultural production is possible through optimisation of the territorial production structure based on natural competitive advantages. Transfer of operational decisions on sub-regional level is an objective necessity, but it must be supported by strengthening of the coordinating role of the centre in matters of territorial distribution of productive forces at the interregional level. Resources and product markets are inter-regional and implementation of large-scale projects will inevitably face with strong market restrictions on access to resources and markets.

The basis of the territorial development of the grain market is the formation of clusters – "symbiosis between cooperation and competition", taking into

account positive synergistic effects of territorial agglomeration, which provides growth potential by leveraging the capabilities of participants. With that, common interest in the outcome stimulates flow of financial resources into the sectors having the highest priority for the development of the cluster as a whole. The current pattern of allocation of grain production of the SES+ allows to form



No.	Name	Crop	Country	Average gross harvest, t mln
1	Export	4, 5 classes of wheat, barley	Ukraine, Russia	51.2
2	Corn	corn	Ukraine, Russia	17
3	High-protein wheat	hard and whole wheat	Kazakhstan, Russia	16
4	Rye	rye	Belarus, Russia	4.4
Potential clusters				
5	Far-east	soy, corn, wheat	Russia	1
6	Buckwheat	buckwheat	Belarus, Russia	0.7

Figure 11.4.
Arrangement of
CES+ grain clusters

the following sub-clusters, "rye", "corn", "export" and "high protein wheat" (see Figure 11.3). At the same time, they account for about 2/3 of the 10 years-average gross grain harvest of the SES+: 90-92 million tonnes. The purpose of creation of sub-regional production clusters is reinforcement (through market mechanisms) of impact on the optimisation of territorial distribution of production, storage and processing of grain, stimulation of development and introduction of new technologies and ultimately improvement of product competitiveness.

Integration processes involve combination of support at the national and supranational levels. At the national level, the support, in our view, should be aimed at addressing operational challenges of the grain sector, however with account to the common strategic approaches developed, through the use of state subsidies (direct and indirect, including tax benefits and preferences) in the agreed scope and directions, in particular, by subsidising production and supporting access to resources, expansion of programme and provision of access to markets. At the same time, price regulation should be moved to the supranational level.

The main tools of price regulation on the basis of analysis of existing national practice and international experience can include the following:

- Establishment of price band for grain purchase prices. The upper level of prices are the prices of the global market, adjusted for infrastructure costs, and the lower level is the minimum guaranteed prices, which are set centrally for all SES+ countries for various crops and climatic zones. The level of guaranteed minimum prices should be low enough and meet the cost of production in the most efficient farms, and the range of crops covered by the application of minimum guaranteed prices, shall be strictly limited. Selection of crops that are subject to support, in addition to income support provides guidance for grain business to change the structure of the area under crop;
- Interventions in the grain market, which in their current form should be replaced with collateral transactions with government support in terms of compensation of part of the costs of storage and insurance of grain. Collateral transactions must be performed under common methodology using warehouse certificates receipts for grain, which apply across the whole territory of the SES+ and are used as collateral for raising loans. In order to increase their liquidity and reduce the cost of loans, ratios of funds reserved by banks with the domestic banks should be reduced, when they are used as a collateral;
- Support of demand for grain in the domestic and foreign markets. In the domestic market, this can be achieved by organising targeted food assistance to needy citizens, implementation of food security programme for

institutions of educational and social sectors, as well as the establishment of rules of priority, compared with third countries, purchases of certain types of products produced in the SES+ for state and municipal needs.

Actual area of stimulation of domestic demand seems to be the development of deep processing of grain, which is one of the main trends of the world market and allows to fulfill ever-growing demand for products, both within the SES+ countries and beyond;

Growth of grain exports as a tool to support the market liquidity is equally important, which requires the formation of a coherent export policy and creation of a relevant organisational mechanism for its implementation. The basic position of a coherent policy on grain export is to avoid imposing any restrictions on its exports and a system of state support measures for export activity. At the supranational level, common principles and mechanisms should be developed to govern the activities of grain exporters (including the creation of a compensation mechanism for voluntary restrictions of grain exports in favour of one of the participants), the development of common trade policy approaches on foreign markets (including identification of priority geographical areas of grain exports), creation of export support centres, including the development of mechanism of interaction with trade missions and associations of entrepreneurs and the formation of a foreign distribution network of the SES+ (foreign trading houses, support centres, regional consignment warehouses and elevators, etc., creation and utilisation of which is carried out by participants from different countries).

Achieving high efficiency of grain sector and ensuring the competitiveness of products is not possible without profound technological modernisation, which in turn requires development of scientific research, public infrastructure and human capital investment. One of the greatest challenges of the present stage of development of the agricultural sector is the “challenge of knowledge”, associated with the risk of insufficient effectiveness of agricultural science, lack of integration of research centres, both among themselves and with the business community, low mobility of researchers and knowledge, lagging behind in the use of modern laboratory, IT and biotechnologies.

Today, national agricultural sectors of the SES+ countries are developing, based on the technology import. Later, however, it is necessary to form own technological reserve, which is possible, in particular, when creating interstate centres of development and promotion of new technologies.

Formation and operation of such centres should be carried out as a private initiative or as public-private partnership (PPP) (investments in research infrastructure, access to databases and genetic resources etc, tax incentives). Funding should be based on terms of public-private partnerships and by obtaining competitive grants of national governments and ECE.

Further progress of agriculture, increase of crop yield, production of grain with specified consumer qualities, addressing and accounting for the effects of global climate change, as well as demographics, becomes impossible without the use of modern biotechnology. However, in this area there is a growing backlog from a number of countries, largely as a result of insufficient level of basic knowledge, and the associated spread of speculative, not confirmed by qualified scientific research statements in the society. Unwillingness to respond to this challenge, the lack of a clear legal framework, large-scale skilled research, responsible independent examination and practice can lead to the fact that agriculture of the SES+ will be weakly prepared for the challenges of the global scientific and technological progress in the grain sector, which carries additional risks for competitiveness as well. In this case, the state policy of silence already has led to the fact that today, at least in Russia and Ukraine, there is an uncontrolled cultivation of genetically modified (GM) varieties of corn, soybeans and canola. To a large extent, the SES+ countries follow the way of Brazil, where cultivation of GM crops has been formally prohibited and, accordingly, was not controlled; as a result, the production of GM soybeans and corn has reached such proportions that the legislation was changed post factum based on the realities of life.

Practical implementation of the proposed approaches requires development of the relevant institutions, some of which should operate on national and others on supranational level. Created and modernised institutions are designed to give an adequate response to the "challenges of dynamism", to remove barriers to the creation of new businesses including the formation of Eurasian grain multinational companies, to create a system of incentives to businesses for taking up risks that could help create more dynamic and flexible environment.

National Institutes of grain market regulation, although their activities are within the competence of national governments, shall be based on the fundamental documents of the SES and ensure compliance with the following principles:

- inadmissibility of business carries out by public institutions in any area, which is similar or close to the functions delegated by the state;
- impossibility to delegate the services provided to farmers to third parties;
- open and free access to the information obtained in implementation of public services.

With that, based on the objectives of the Grain policy, it is necessary to form a number of institutions to implement functions of supranational regulation. The main institution is the financial foundation of CAP created to fund joint research programme and projects, conducting operations to regulate the grain market and reserve fund of seeds, support the development of innovation infrastructure, etc.

At the expense of that fund, among others, the following activities shall be financed:

- joint research projects, formed based on co-financing from the budgets of all participants, where all the results obtained are generally available for businesses of national economies;
- joint reserve fund of seeds and food grains (wheat) for use in emergency situations. The Fund is formed by each SES country proportional to the area under crops on the basis of 10% of annual demand of winter crops and 2-month consumption volume. Accumulation of resources and storage of grain of the Fund is carried out on national territories, and the decision on its use in the interests of a member of the SES is made on collegial basis. Deliveries are made for value.

Realisation of the proposed approaches in implementation of a common grain policy assumes active development of public-private partnership (PPP) in grain sector of the SES (research and development, irrigation projects, transportation projects, including terminals, etc.) that can be achieved as a part of the establishment and operation of a public-private partnership centre of the SES. The main objective of the centre is to promote and facilitate the development of the SES market with regard to PPP projects having strategic importance and serving the interests of businesses from all or part of the SES countries, as well as development of relations with economic partners of the SES. The centre should cooperate with national authorities in the selection and approval of priority projects and prepare proposals for participation of the SES in implementation of specific projects.

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12

Developing Commodity Exchange Trading in the Single Economic Space

Natalia
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SUMMARY

Commodity exchanges account for nearly 20% of operations involving trade in raw materials. This fact predetermines the role international commodity markets play in establishing and regulating world prices. Exchange quotations serve as price indicators for nearly all of the global trade in grain, cocoa beans, cotton, rubber and many other commodities. Exchange operations are used to hedge against commodity price volatility. The commodity exchange is not only a place for concluding transactions, but an information centre concerning any particular traded commodity. This market and price information is also used in the off-exchange trading.

Commodity exchanges have evolved from local markets trading physical commodities to high-liquidity international markets trading futures and forward contracts. Many research examined the development role of commodity exchanges. UN Conference on Trade and Development (UNCTAD) sees commodity exchanges as trade-facilitation institutions able to stimulate economic growth in developing countries by reducing transaction costs along the commodity supply chain (UNCTAD, 2007). It suggests a link between activity on commodity exchanges and improvements in the wider environment of commodity sectors. In many developing countries exchange mechanisms promote the wider involvement of isolated commodity sector participants in

economic relations. It should be remembered that profits are not generated merely by the establishment of a commodity exchange. Viable commodity exchange mechanism requires complex regulation and involvement of a government.

Exchange trade is continually developing and trading operations and instruments are becoming ever more complex. Notable trends in the sector include: a reduction in the number of commodity exchanges; the transformation of specialised into universal commodity exchanges; changes in the role and function of the commodity exchange as a financial institution; technological developments and growth in the number of commodity exchange participants; the gradual unification of commodity exchange on a global scale; and changes in the way commodity exchange operations are regulated.

The revival of activity on the Russian commodity exchange was a milestone in the country's transition to a market economy. Despite its turbulent history, the Russian commodity exchange sector is following international development trends thanks to its adoption of international standards and best practices in the operations of Russian exchanges and market regulators and the proximity of highly competitive foreign markets. Exchange trading in Kazakhstan has still not matched turnover it enjoys in the West and in Russia. The country's commodity exchange sector is still in development. However, for Kazakhstan, as the exporting country with huge raw material and agrarian capacity, the proliferation of exchange trade is seen as viable instrument. With the creation in 2008 of the Eurasian Trading System (ETS) and adoption of Law on Commodity Exchange in 2009, Kazakhstan has entered a new phase in commodity trade development.

The research undertaken jointly by the EDB and the IAE CIS has shown that national commodity market regulation in Russia, Kazakhstan, Belarus and Ukraine is hindering inter-exchange cooperation on organised commodity markets. It is now time to define and adopt priorities for the development of an organised inter-state commodity exchange. It is clear that the differences in legislation on organised commodity trade are a serious barrier to inter-exchange cooperation.

The results of comparative analysis of the legislation on organised commodities market in SES countries be used to develop a comprehensive commodity exchange model for SES countries, based on common principles of operation, provision of access to professional participants, regulation of trading floor procedures and size of assets, information transparency, contract guarantees and risk management.

A large number of issues will need to be addressed in order to achieve the necessary level of legislative unification between the member states. This will require collaborative efforts by regulators, commodity exchanges, industry

association (IASE CIS) and other interested parties. A special oversight authority dedicated to the sector should be created to coordinate development efforts in the organised commodity market, similar to those established for the stock markets in the CIS and EurAsEC regional organisations.

The effect of commodity exchange on development and trends in exchange trading

Specialised international organisations study the issues related to the development of trade and the impacts of trade on development. One of the leading agencies in this field is the UNCTAD. This agency published wealth of studies to this matter. In one publication on the development role of the commodity exchanges (UNCTAD, 2007a) commodity exchanges are seen as trade-facilitation institutions that can trigger growth in developing country commodity sectors by reducing transaction costs along the commodity supply chain. The research suggests that there is a link between commodity market activity and an improved environment for the development of related sectors. If, for example, the commodity exchange stimulates development of a network of storage facilities to improve delivery and collateral management, this can have a positive effect on storage and logistics infrastructure for traded commodities. The presence of a reliable system of credit – in particular for warehouse receipts – may, in turn, lower the banks' credit risk for agricultural producers and increase the attractiveness of trade financing.

A substantial body of knowledge has been built on development impact of commodity trade, including a collection of case studies, based on countries' experiences on developing commodity exchanges. In Latin American countries, for example, "innovative application" of the commodity market mechanism has led to the greater involvement in economic relations of previously isolated commodity sector participants. Financing mechanisms is one of several broad categories in which the use of exchange mechanisms was put to good use. Commodity exchanges in Colombia and the Bolivarian Republic of Venezuela, for example, created mechanisms that allow the commodity sector to plug into local capital markets via trade on the exchanges of farmers' repurchase agreements, thus bypassing the banks. These tools are especially attractive in instances where banks are reluctant to deal with high agricultural risks. Another area of innovation has to do with an upgrade of physical markets. In 2002, Brazil's BM&F founded Brazilian Commodity Exchange (BBM) as a dedicated agribusiness exchange. It linked agriculture, commerce, industry, finance and government. Having effectively united six previously isolated regional markets, the BBM's upgraded and commercialised the country's agricultural sector and provided mechanism for implementing state agricultural policy.

As stated above, benefits are not derived as a direct result of commodity exchange establishment. The exchange mechanism requires complex regulation. The role of the state here is twofold: an oversight role (eradicating malpractice

and market manipulation, enforcing contractual obligations) and enabling role (creating the necessary legal and regulatory environment and, where necessary, elements of physical infrastructure).

Regulation has three objectives: to guarantee market integrity, to uphold financial integrity and to protect the interests of investors from malpractice or the irresponsible behaviour of counterparties and market intermediaries. Regulation is effected at three levels – on the market as a whole; on the commodity exchange; and on the intermediaries between the commodity exchange and clients. Generally speaking, global commodity market experience has shown the futures market¹ to be a highly regulated environment with a multi-layered system of supervision, in which the various "layers" are mutually reinforcing. Table 12.1 shows selected standard elements of a regulatory system according to the objectives and application level.

Table 12.1.
Elements
of commodity
exchange regulation

Source: materials of the expert meeting on trade and development implications of financial services and commodity exchanges, Commission on Trade in Goods and Services and Commodities, UNCTAD, September 2007

Objectives	Market-level regulation	Exchange-level regulation	Intermediary-level regulation
Market integrity	<ul style="list-style-type: none"> • Registration and licensing of exchanges, clearing houses and intermediaries; • Procedures for approval of new contracts; • Supervision aimed at preventing manipulation of the market, non-competitive behaviour and other malpractice; • Auditing of self-regulating organisations (SROs); • Information exchange with foreign regulators to monitor participants and/or cross-border transactions; • Legal framework for the application of sanctions on market participants or institutions in cases of malpractice 	<ul style="list-style-type: none"> • Time-stamped audit trail of all trading activity; • Transparent reporting of transactions, prices and other market information for all participants; • Toughening up of requirements on position limits; • Audio and video surveillance of trading floor activity; • Accreditation and monitoring of delivery facilities; • Sensitive data treated with highest levels of confidentiality and security by exchange personnel and systems 	<ul style="list-style-type: none"> • Good character (or "fitness") requirements for market intermediaries; • "Know your customer" requirements (including anti-money laundering provisions); • Protection of clients from malpractice and misuse of funds
Financial integrity	<ul style="list-style-type: none"> • Clearing houses minimum capitalisation requirements; • Intermediary financial reporting requirements on brokers and intermediaries; • Requirements for the use of established accounting standards for positions taken in the markets 	<ul style="list-style-type: none"> • Clearing-member minimum capital requirements and capital-based position limits; • Clearing- house guarantee funds to compensate member losses in the event of default (fund created by clearing member contributions and backed by a default insurance policy); • Special measures for high volatility cases – trading halts, cool-off periods and imposition of special margin 	<ul style="list-style-type: none"> • Margin deposits from clients; • Client minimum capital requirements and capital-based position limits

¹ At the beginning of the third millennium, physical trade in raw materials and commodities predominantly belongs to off-exchange, while exchanges feature trade in futures and options on the main commodities.

Objectives	Market-level regulation	Exchange-level regulation	Intermediary-level regulation
Investor protection	<ul style="list-style-type: none"> • Legal framework that provides: (i) legal certainty for recognition of contracts and associated obligations of counterparties; (ii) definition of legal relationships between market participants in transaction execution, clearing and settlement, and delivery (clients, brokers, exchanges, clearing houses and settlement banks); • Monitor exchanges to ensure fair and equitable treatment of all participants; • Oversight of exchange governance – governing boards to reflect interests of all major stakeholders 	<ul style="list-style-type: none"> • Defined, transparent, binding rules and bylaws governing exchange operations, especially the delivery process; • Binding arbitration mechanisms for resolution of member disputes; • Binding sanction mechanisms for members in default of obligations 	<ul style="list-style-type: none"> • Qualification standards for, and licensing of, market intermediaries; • Governance of intermediary marketing practice (e.g. advertising standards, client solicitation and fee disclosure); • Segregation of client fund from brokers' own funds; • Best execution requirements for brokers

The above is regarded as a basic set that guarantee the effectiveness of a regulatory system. In practice, governments often use expanded or reduced set of measures as they have to maintain a proper balance between maximisation of benefits that regulation brings along to market participants against the costs imposed on them in the performance of the regulatory functions. Governments also face a challenge to find a balance between external regulation by a government authority and self-regulation by the industry or its representative bodies. Getting this balance right is a function of the degree of confidence of both government and market participants in market institutions that could potentially act in a self-regulatory capacity.

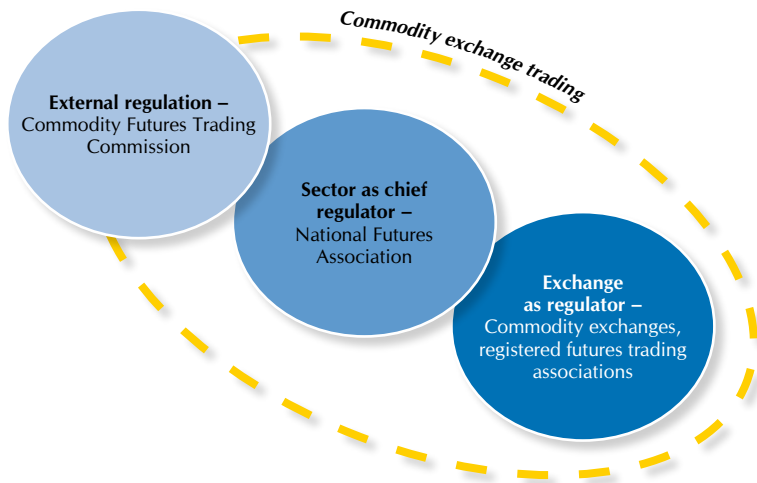


Figure 12.1.
Regulation
of the futures market
in the USA

Information:

CFTC was created by the US Congress in 1974 as an independent government agency. The agency's mandate has been renewed and expanded several times since then. Today, the CFTC is authorised to regulate commodity futures and option markets in the United States and to protect market participants and the public from manipulation and malpractice relating to the trading of commodities, financial futures and options. Apart from the markets and their participants, the CFTC also supervises commodity exchanges, clearing organisations, brokers, dealers, consultants, fund managers and the representatives thereof.

NFA is a specialised, sector-wide, self-regulating organisation for futures trading. Established in 1982 "to protect the rights of the participants of the futures market by providing ethics in futures and other (including currency) markets and to protect the interests of traders and investors". All broker companies licensed by the organisation are obliged to comply with its requirements and the regulations of the commodity exchanges on which they trade. These are designed to provide financial reliability, rigorous compliance with US federal financial regulations in respect of the procedures used for paying off orders, the submission of reports on stock exchange and Internet trading, the financial limits on positions, the defining of trader price limits, trading policy standards and commercial behaviour. Infringements of stock exchange regulations are subject to financial penalties, suspension or withdrawal of the NFA licence. The organisation unites 3,800 companies and 55,000 associate members. The organisation is financed solely by membership contributions and fees paid by trading participants for futures market appraisals. Stock exchanges and registered futures associations are obliged to introduce minimum reporting standards for all members.

The system appears reasonably thought out and reliable. And yet scandals involving representatives of the sector continue to hit the headlines. These result in losses for clients and consequences for the entire industry. For example, the annual report of the National Futures Association (NFA) for 2012 (NFA, 2012) publishes a letter from Daniel J. Roth, its President and Chief Executive Officer, and Christopher K. Hehmeyer, Chairman of the Board, in which they talk about collapse, in 2011, of one of the largest futures commission merchants – MF Global Inc: "The shortfall of an estimated \$1.6 billion dollars in customer funds – funds that should have been securely deposited in customer segregated fund accounts and customer secured amount accounts for customers trading on futures exchanges – dealt a severe blow to the public's confidence in the financial integrity of the futures markets".

In June 2012, another scandalous news became public when the Peregrine Financial Group announced insolvency after revealing that the president of the company had used clients' segregated accounts for his own purposes and falsified reporting to the NFA. Over a nine-month period, therefore, it was twice

demonstrated to clients of futures commission merchants that they could no longer consider their segregated accounts to be safe and secure.

On April 21, 2010, Vedomosti reported that the US Securities and Exchange Commission (SEC) had accused the American investment bank Goldman Sachs of concealing information about the bank's financial standings, in order to mislead shareholders intentionally. It was reported that Goldman Sachs investors stood to lose up to \$1 billion due to the speculative activities of the bank's management. It was only after April 19, that the price of the Troy ounce on the New York Stock Exchange (NYSE) fell by 0.7%. This scandal affected not only the US exchanges, but also many other exchanges worldwide. This came not long after the activities of persons such as Bernard Madoff (2008, \$65 billion loss), Alan Stanford (2009, \$8 billion loss), Jerome Kervel (2008, \$8 billion loss) had made the headlines (see: <http://nyse-trade.ru/>).

So, the question arises as to what happens then in countries, in which the infrastructure, institutes, regulatory systems and practices are still in their development stage? It could be possible that underdevelopment of futures markets in terms of sophistication of instruments and exchange trade participants serves them a measure of self-protection.

Nonetheless, commodity markets function in both open and restricted economies. Some were created on a wave of economic reforms, others during political transformation and the transition to free market economy. There are commodity exchanges in countries whose economic systems combine large-scale commercial production and small-scale producers. In some countries, commodity markets serve domestic markets, in others they are aimed at exports. While many commodity exchanges operate in countries in which the market infrastructure, institutions and procedures are highly developed, and national markets are well integrated, they have also been successfully established in countries whose markets are in need of further development and integration. Commodity exchange trading is continually developing and trading operations are becoming ever more complex. The important trends in the development of the commodity exchange sector will be discussed in the next section.

COMMODITY EXCHANGE TRADE: TRENDS AND DEVELOPMENTS

Based on the data published by the Futures Industry Magazine in early 2013, the total turnover from futures and options trading by category of commodity during the first half of 2012 looked as following (see Figures 12.2 and 12.3). Futures Industry Association collects data on the number of contracts traded and/or cleared on 84 exchanges worldwide.

The diagram illustrates the general breakdown between financial and commodity futures and options in the total turnover for the first half of 2012.

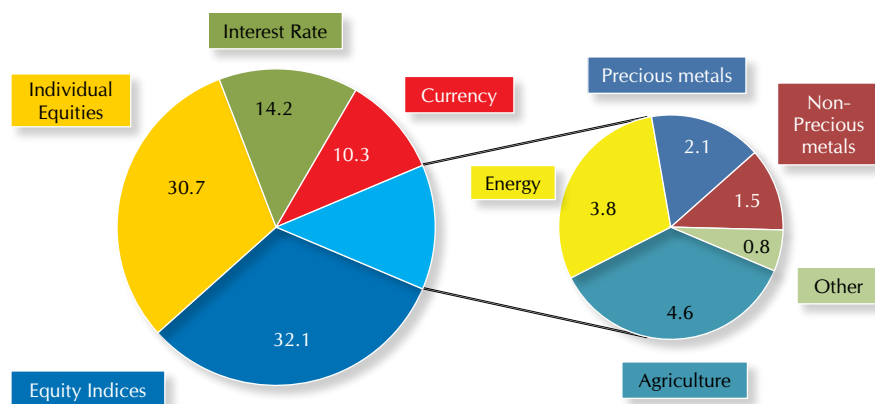


Figure 12.2.
Global volume by
category (%)

Source: Futures
Industry Association,
www.futuresindustry.com

The data indicates that agriculture (4.6%) is the largest individual element of commodity futures and options trade. The section labelled "other" (0.8%) includes exotic contracts, based on commodity indices, credits, fertilizers, housing, inflation, plastics and weather.

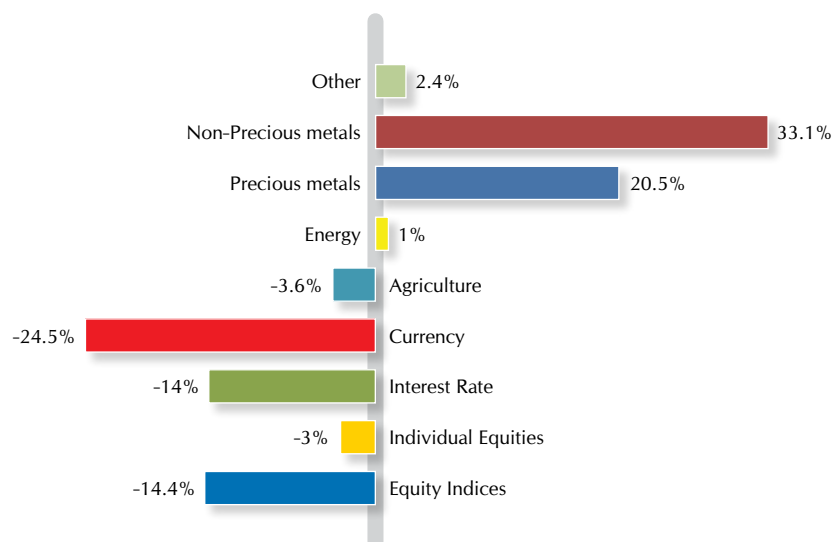


Figure 12.3.
Global futures
and options volume
(2011-2012,
% change)

Source: Futures
Industry Association,
www.futuresindustry.com

Trading in agricultural futures and options showed negative growth. Energy trade increased slightly. There was an appreciable growth in the volume of

futures and options for precious and non-precious metals. The dynamics of these indices against January-June 2011 performance, is shown on *Table 12.2*.

Table 12.2.
Dynamics of global
futures and options
volume (2010-2012,
% change)

Source: the Futures
Industry Association,
www.futuresindustry.
com

Type	% Change 2010-2011	% Change 2011-2012
Equity Indices	14	-14.4
Individual Equities	6.1	-3
Interest rate	11.6	-14
Currency	22	-24.5
Agriculture	-9.1	-3.6
Energy	16	1
Precious metals	-37.7	20.5
Non-precious metals	49.8	33.1
Other	71.3	2.4
Total	10.2	-10.2

In the breakdown of global futures and options volume by region, Latin American growth (+19.4%) stands out, although commodity exchange turnover in the Latin American countries is considerably lower than in other regions (see *Table 12.3*):

Table 12.3.
Global futures
and options volume
by region (\$ billion)

Source: the Futures
Industry Association,
www.futuresindustry.
com

Region	January-June 2011	January-June 2012	% Change
Asia Pacific	4.91	3.96	-19.3
North America	4.04	3.76	-7
Europe	2.5	2.32	-7
Latin America	0.78	0.93	19.4
Other	0.17	0.16	-7.1
Total	12.4	11.13	-10.2

To complete this brief statistical overview, the data on the top ten Derivatives Exchanges in 2012 is given in *Table 12.4* and *Figure 12.4*.

It is notable that Russia's Micex-RTS (as the Moscow Exchange is referred to on the FIA website) appears on this list and, moreover, with a positive dynamic. According to FIA statistics, the Micex-RTS is in the top twenty Energy Futures and Options Contracts (Brent Crude Oi Futures, ranked 16th), the top twenty Equity Index Futures and Options Contracts (RTS Futures, ranked 6th) and also

Rank 2012	% Change (volume) 2011-2012	Commodity Exchange	% Change (volume) 2010-2011	Rank 2011
1	-8.9	CME Group	8.7	2
2	-34.4	Korean Exchange	19.2	1
3	-11.1	Eurex	-4.4	3
4	-12.2	NYSE Euronext	-3.4	4
5	-7.2	National Commodity Exchange of India	33.7	5
6	19.1	BM&Fbovespa	0.8	6
7	1.7	CBOE Group	-2.8	8
8	-13	Nasdaq OMX	28.5	7
9	10.6	Micex-RTS	58.1	10
10	-13.8	Multi-Commodity Exchange of India	2.2	9

Table 12.4.
The top ten Derivatives Exchanges ranked by number of contracts traded and/or cleared

Source: Futures Industry Association, www.futuresindustry.com

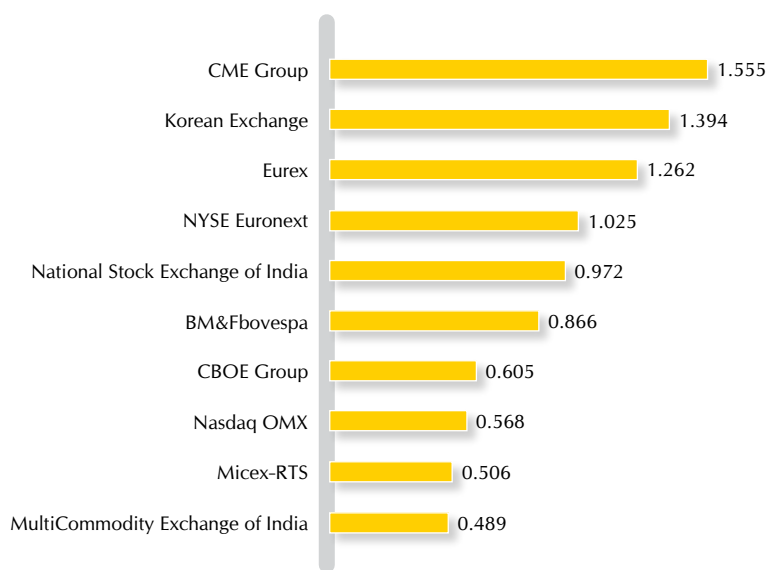


Figure 12.4.
Volume of contracts traded and/or cleared in January-July 2012 (billions)

Source: Futures Industry Association, www.futuresindustry.com

in the top twenty Foreign Exchange Futures and Options Contracts (ranked 10th with Euro/US dollar Futures).

According to FIA statistics, the futures and options market did not do well in the first half of 2012. On the 84 global commodity exchanges, 10.2% less contracts were traded and/or cleared than in the same period in 2011.

The top ten commodity exchanges did not show any major change in participants. In terms of the volume of contracts traded and /or cleared almost all of them, with the exception of BM&FBovespa, the CBOE Group and Micex-RTS, slowed down. Positive movement was seen in the trading of futures and options contracts for precious and non-precious metals and energy. The remaining commodities showed negative growth. Breakdown by the region shows certain fluctuations, but apart from in Latin America the downward trend prevails. These were the major trends in commodity exchange volumes during 2012.

Commodity exchanges have evolved from local markets trading physical commodities to high-liquidity international markets trading futures and forward contracts. They are an excellent example of a self-regulating market institute and have become an integral part of the production and financial operations of a vast number of economic entities. While maintaining their original characteristics – ensuring transparency of the trading process and competitiveness in the concluding of transactions – commodity exchanges have improved technically and in terms of the number of different operations performed and contracts handled. The following section deals with the trends, which shape the future developments in the commodity markets worldwide.

CURRENT TRENDS IN THE DEVELOPMENT OF ORGANISED COMMODITY TRADE

One of the main international trends today is the reduction in the number of commodity exchanges and the merging of specialised into universal commodity exchanges. Most of the mergers were pursued to increase the financial competitiveness of the commodity exchanges in the face of European competition and to offer institutional and commercial clients lower servicing costs. Europe's electronic trading was seen as less costly than the open outcry trading system prevailing in the US, in which all bids are made publicly.

One of the biggest changes was the creation of the CME Group from the merger of the Chicago Mercantile Exchange (CME), the Chicago Board of Trade (CBOT) and the New York Mercantile Exchange (NYMEX). The CME Group is now the world's largest commodity exchange by the volume of futures traded and offers its services at highly competitive rates. The new, fully electronic Inter Continental Exchange (ICE) was created in the US in 2000.

Commodity exchange mergers have also taken place in Europe and Asia. Larger exchanges acquired their smaller counterparts, and smaller exchanges merged to protect themselves from potential takeover. This trend is likely to persist. Once enlarged, commodity exchanges become ever more integrated into the international market. *Table 12.5* shows the important mergers and takeovers that have taken place over the last two decades.

Table 12.5.
Mergers and Acquisitions

Period	Commodity exchanges and processes	Result
<i>North America</i>		
August 1994	Merger of the largest commodity exchanges in New York: New York Mercantile Exchange Inc. (NYMEX) and Commodity Exchange Inc. (COMEX)	Creation of the New York Mercantile Exchange, the world's largest commodity exchange trading derivative instruments for oil and natural gas, precious and non-ferrous metals, electricity, etc.
June 1998	Merger of Coffee, Sugar & Cocoa Exchange Inc. (CSCE) and New York Cotton Exchange (NYCE) and its subsidiary structures Citrus Associates (the division for trading citrus product instruments), FINEX (financial division) and the New York Futures Exchange	Creation of the New York Board of Trade (NYBOT), handling instruments for trading agricultural products, currency, financial instruments and indices. NYBOT also becomes the largest commodity exchange for trading sugar derivatives.
November 2001	Foundation of joint enterprise OneChicago LLC by the Chicago-based CBOE, CME and CBOT exchanges	Creation of a single Chicago commodity exchange for the futures trading of a range of securities and stock indices with a narrow allocation base. Members of the CBOE, CME, and CBOT commodity exchanges are also members of OneChicago.
November 2003	Agreement to create the CME/CBOT Common Clearing Link	CME Clearing House to provide clearing and associated services on CBOT-traded instruments for the Chicago Board of Trade.
January 2013	<p>In little more than a decade, the Intercontinental Exchange has grown from a start-up focused on the US energy and gas markets to a multinational company trading almost all types of assets capable of influencing global derivative markets. The ICE has since acquired the International Petroleum Exchange, New York Board of Trade, the Winnipeg Commodity Exchange, The Clearing Corporation and the Climate Exchange, uniting and integrating them into a complex of markets and clearing houses.</p> <p>In one of its most recent and most ambitious deals, ICE is attempting to purchase NYSE Euronext (parent company of the New York Stock Exchange and icon of the US stock markets) and LIFFE, the second largest European futures commodity exchange. Approval by the regulator and shareholders of this merger will make ICE the leading force in futures and options trading on the % rate index and on cash equities markets.</p>	
<i>Latin America</i>		
May 1991	Merger of the Bolsa de Mercadorias de Sao Paulo (BMSP), Brazil's first commodity exchange, with the Bolsa Mercantil&de Futuros (BM&F) futures trading commodity exchange	Creation of BM&F joint commodity–futures exchange
June 1997	Merger of the BM&F commodity–futures exchange BM&F with the Bolsa Brasileira de Futuros – (BBF) futures stock exchange	Creation of BM&F, the largest forward market commodity exchange in Latin America and one of the top ten Derivative Exchanges.

Period	Commodity exchanges and processes	Result
2008	Merger of Brazil's BM&F Commodity Futures exchange and the Bovespa Stock Exchange of São-Paulo	Merger
<i>Europe</i>		
1992	Merger of LIFFE with LTOM London Stock Exchange options market trading house	Diversification transforms LIFFE into one of the largest commodity futures exchanges in the world. LIFFE was renamed the London International Financial Futures and Options Exchange and therefore retained its abbreviated title.
1996	Merger of London Commodity Exchange (LCE) with LIFFE	
December 1996	The German Commodity Exchange (Deutsche Boerse AG) and the Swiss Exchange signed a protocol merging their subsidiary commodity futures exchanges: Germany's Deutsche TerminBoerse (DTB) futures exchange and the Swiss Options and Financial Futures Exchange (SOFFEX). The merger of DTB and SOFFEX was finally completed in 1998. The merger also created the EUREX Clearing subsidiary clearing house	Creation of EUREX, Europe's largest commodity exchange for derivative instruments. EUREX has since become the world's leading commodity exchange in terms of trading volume.
September 2000	Merger of the Paris Bourse SBF SA, Amsterdam Exchanges and Brussels Exchanges.	Creation of the single European commodity exchange EURONEXT NV, integrating the trading, clearing and settlement systems for the stock, futures and commodity markets of all three exchanges. EURONEXT operates on three commodity markets: Euronext Amsterdam, Euronext Brussels and Euronext Paris.
<i>Asia Pacific</i>		
December 1998	Merger of the Kuala Lumpur Commodity Exchange (KLCE) and its subsidiary, the Malaysia Monetary Exchange (MME)	Formation of COMDEX, the single Commodity and Monetary Exchange of Malaysia.
<i>Inter-continental takeovers and alliances</i>		
June 2001	Takeover of the London Commodity Exchange IPE by the American Intercontinental Exchange (ICE)	Emergence of a global electronic trade platform trading energy derivative instruments. Creation of a serious competitor to NYMEX.
June 2003	Signing of a memorandum of understanding extending cooperation between NYMEX and the Tokyo Commodity Exchange (TOCOM).	Under the terms of the memorandum, the commodity exchanges granted participants access to all trading instruments and allowed them to cooperate on the development of new products in new areas of activity.
February 2004	Agreement between the Board of Trade Clearing Corporation (BOTCC) and Eurex US, the American subsidiary of the Eurex commodity exchange, on the provision of services by the clearing corporation	Creation of a US futures market alliance between one of the world's largest clearing houses – BOTCC – and the world's largest commodity futures exchange – Eurex. Entry of Eurex into the US market.
2007	Merger of NYSE with the Euronext group of European commodity exchanges	Merger
2008	Nymex bought out by CME Group	Takeover

Period	Commodity exchanges and processes	Result
2011	Negotiations on acquisition of Chi-X Europe by the US alternative trading platform BATS Global Markets in a deal worth around \$300 million. According to Thomson Reuters, Chi-X Europe and BATS Europe, the European subdivision of the BATS Global Market, was set to take 22.9% of the combined European market, with the Deutsche Boerse/NYSE receiving 29.7% and the LSE 23.4% (Koksharov, 2011).	The commodity exchanges withdrew from the deal on February 2, 2012.
2011	NYSE Euronext and Deutsche Boerse merge to create the largest commodity exchange for derivatives trading. The European Commission came out against the merger and blocked the deal on February 15, 2011. This was the second time that a plan to merge Deutsche Boerse and NYSE Euronext had failed. The first negotiations were conducted in 2008 following the NYSE's purchase of France's Euronext trading platform. That deal also foundered.	Merger negotiations did not take place.
2011	Russia's MICEX (Moscow Interbank Currency Exchange and RTS (Russian Trading System) unite to form the Moscow Commodity Exchange	Merger
December 7, 2012	The Hong Kong Stock Exchange (HKEx) completed its acquisition of all ordinary shares issued on the London Metal Exchange (LME). The acquisition was reported by the Xinhua agency. For over 135 years, the LME has been the main depository for buyers of metals, including copper, aluminium and nickel, consumption of which is greater in China than in any other country. The acquisition looked promising given the record levels of trading on the London Commodity Exchange. Trading in September was at its highest level since records began. In September alone, over 14 million contracts were signed. The volume of transactions carried out on the LME since the beginning of the year exceeded that of the same period in 2011 by 8%. In 2011, over 146 million contracts amounting in total to \$15.4 trillion were concluded on the LME.	HKEx issues 65.7 million new shares to be distributed among independent professional and institutional investors, thus attracting 7,753 billion HK dollars (\$1 billion). These shares represent around 5.71% of the shares already issued.

Source: Solovyev, 2004; updated by materials from various business publications

Another important development trend is the commodity exchange's transforming role and function to that of a financial institution. The commodity market has been transformed from a market dealing in goods to a market dealing in entitlement to goods. The universalisation of commodity exchanges and the diversification of instruments traded has led to a significant reduction in the number of transactions involving physical commodities and a lowering of the volume of these transactions as a percentage of total commodity market turnover. The transition from trading in physical goods to trading in their derivatives has altered the primary function of the commodity exchange from organising the sale of commodities to servicing trading operations (Samarin, 2007). This trend gathered significant momentum after the start of the new millennium in 2000 and its effects are likely to be far-reaching.

The idea of a forward market is fundamental to classic economic theory and is seen to have a number of important functions. These include price risk control, the provision of information for commercial agencies, speculation and the creation of new financial instruments (Mikhailov, 2000). Today, however, the volume of trade in derivatives (futures, options, commodity swaps, etc.) by far exceeds the volume of trade in underlying commodities (Moryi, Maqsimchuk, 2012). In a number of commodity groups, e.g., crude oil, petrochemicals, precious metals and grain, this is leading to distortions in the price-setting mechanism. The traditional method of price formation on spot markets based on the supply and demand of real producers and consumers is being distorted. In many cases, prices are now being set on forward markets, where the financial strengths of the major investment houses are pitted against each other in an attempt to pursue speculative ventures based on the predictions of their own and other independent analysts. The hedging operations carried out using the financial resources of real producers and consumers, financial assets and products have also given way to poorly regulated, speculative trading operations undertaken by the many offshore hedge funds, trusts, etc., able to operate with excessive amounts of financial capital. Such a situation calls for the introduction of more rigid controls, although it is possible that once regulation has been introduced, the trend described above will begin to weaken; at this moment in time, however, the futures market is in a dominant position with regard to the spot market.

According to researchers, the trends that now typify the development of the sector as a whole are technological development and the growth in the number of commodity market participants. The development of commodity exchange trading globally has led to a significant increase in the number of commodity market participants and a broadening of the spectrum of economic entities trading on the markets. Traditional derivative market participants have now been joined by governments, state financial institutions, international financial companies, transnational corporations, banks, insurance societies, pension funds and private investors. This is due to changes in legislation in developed countries, which have institutionalised innovative commodity exchange mechanisms (Samarin, 2007).

The transition from the "open outcry" system of traditional commodity exchange trading to electronic trading has been made possible by advances in communications technology and their introduction to market trading practices. The new commodity exchanges created at the end of the 20th century (see ICM above) are all orientated towards electronic trading. The first commodity exchange with a fully electronic trading system was the New Zealand Futures and Options Exchange, which opened in 1985. According to the Chairman of the Chicago Chamber of Commerce, D. Brennan, the global volume of electronic trade doubled between 1995 and 1998, whilst the volume of "auction" trading fell by 17%. This trend is set to continue.

Table 12.6.

Volume of commodity futures by selected commodity exchanges

Stock Exchange	Volume traded (number of contracts)		Notional value (\$ millions)		Open interest (number of contracts)		Number of trades	
	2011	2010	2011	2010		2011	2010	2011
BM&FBOVESPA (Agricultural futures)	2,040,475	2,275,100	41,035	35,983	36,837	41,687	568,761	492,817
CME Group (Agricultural, energy and metal futures)	608,579,048	541,540,557	47,168,617	33,625,981	25,866,122	29,071,949	328,799,168	275,343,005
Dalian Commodity Exchange (Agricultural futures)	289,047,000	403,167,751	2,616,862	3,084,985	1,580,328	1,489,899	NA	NA
Shanghai Futures Exchange (Agricultural, energy and metal futures)	308,239,140	621,898,215	6,738,220	9,133,773	1,070,010	1,032,316	NA	NA
Tokyo Commodity Exchange (Agricultural, energy, metal and commodity index futures)	31,670,031	27,636,367	1,210,782	808,335	323,801	348,032	NA	NA
NYSE LIFFE (European markets) (Agricultural futures)	17,265,995	14,133,913	406,510	304,149	642,029	662,954	5,145,379	3,477,061
RTS (Agricultural, energy and metal futures)	36,764,175	17,784,436	57,081	18,296	79,845	93,178	2,793,293	936,407
Budapest Commodity Exchange (Agricultural futures)	5,318	6,854	177	166	221	506	1,452	1,759
Eurex	58,755	53,407	891	528	6,562	7,109	17,491	16,961
Zhengzhou Commodity Exchange (Agricultural futures)	406,439,457	495,904,984	NA	NA	935,600	793,956	NA	NA
ICE Futures Europe (Energy futures)	257,993,927	210,402,962	NA	NA	2,928,494	NA	NA	NA
Multi Commodity Exchange of India (Agricultural, energy and metal futures)	346,192,367	197,206,801	NA	1,905,357	NA	NA	NA	NA
NYSE Euronext (US markets) (Metal futures)	3,655,545	3,730,746	NA	NA	9,570	13,574	NA	NA

Source: <http://www.world-exchanges.org/statistics/derivatives>

Note: NA – data not available

During the mid-1990s, commodity derivatives exchanges began to emerge in developing countries and in the countries of the former Soviet Union. This broadened the geography of commodity exchange trading. However, the major commodity exchanges are nonetheless concentrated in the world's leading financial centres, due to the presence in those centres of a developed banking infrastructure, capital, an effective system of regulation and better investor protection – in other words, a favourable environment for exchange industry.

The US is the leading futures trading nation. It gained this leading position in part thanks to the Commodity Futures Modernisation Act of 2000.

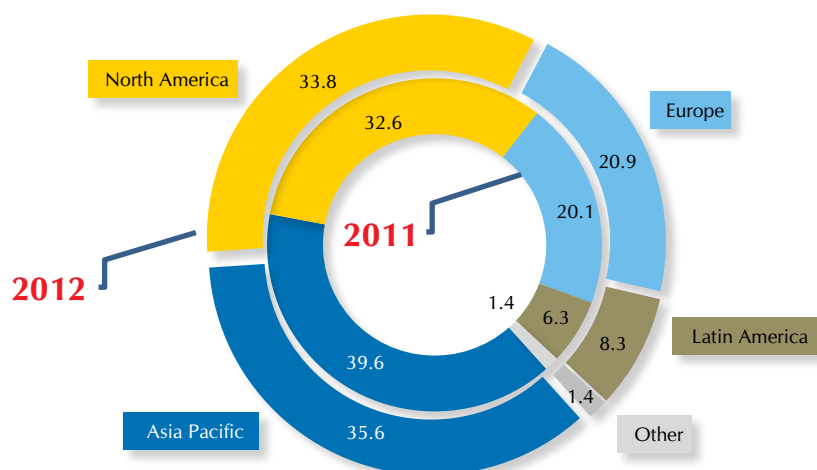


Figure 12.5.
Global Futures and
Options Volume by
Region (% change,
2011 and 2012)

Source: Futures
Industry Association,
www.futuresindustry.com

The range of underlying commodities is increasing. During the 1960s and 1970s, futures contracts markets expanded to include more than 20 new commodities. These included timber, gold, silver, palladium, oil, propane, orange juice concentrate, various kinds of meat and meat products. New commodities are sometimes brought onto the contracts market through deregulation of the underlying sector – electrical energy, for example. This is the case in most European countries and in the US. The inclusion of new industrial raw materials (crude oil, diesel, nickel, aluminium, timber, plywood) alongside traditional ones has led to increases in the number of commodities and in the volume of commodity exchange trading. As a result, agricultural and forestry products account for a smaller proportion of all the exchange commodities, although still ranked high. Nowadays, a brief glance at the list of exotics is sufficient proof that just about any type of commodity can be traded.

Probably the most important trends are the ongoing unification of commodity exchange organisation on a global scale and changes to the methods of regulating commodity exchange activity. Unification of commodity exchange organisations is taking place in the wake of global trade liberalisation and financial globalisation. One of the major examples of unification is the individual currency in which all the forward contracts are quoted – the US dollar. Although supervisory and control functions rest with the state, many powers are now being transferred to trading organisers and self-regulating bodies in the sector. However, the recent financial crisis and the scandals in the financial sector may prompt a return to stricter regulation.

World-wide experience shows that trade in commodities has little bearing on real economy these days and is increasingly becoming part of the financial market. Globalisation of economy prompts the unification of exchange trade organisation and emergence of international entities, which influence global commodity prices. Emergence of new commodity exchanges stimulates regional integration by providing modalities for the conduct of cross-border transactions and links between commodity-sector participants domiciled in different jurisdictions. Recently, the number of participants has significantly increased due to changes in legislation and technological advances which have profoundly altered the way commodity exchanges operate.

Having visited the issues of development, regulation and trade volumes in derivatives, we go on to look at what is happening in the CIS.

THE MAIN PHASES OF DEVELOPMENT OF THE COMMODITY EXCHANGES IN RUSSIA AND KAZAKHSTAN

The events which led to development of commodity markets in Russia and the newly independent states (NIS) following the collapse of the USSR, have been well studied and documented in the works of that period (e.g., Shatalin, 1990; Manevich, 1991).

The processes of disintegration had a profound political and economic impact. The collapse of the Soviet single economic area and the introduction by the NIS of their own currencies and customs borders destroyed old, established cooperation links. The economies of all these countries were in crisis at the beginning of the 1990s, with zero economic growth, falling industrial production, growing budget deficits, rising inflation and widespread commodity shortages.

The industrial enterprises of the CIS member states found themselves in entirely new economic circumstances. Centralised supply was swept away with the old system and traditional economic links were broken. Commercial relations moved towards a system of free price setting. For producers, the transition to a market economy required economic structures that could support the creation of new cooperative links and new price orientation. In other words, commodity exchanges became not only a reality, but a necessity for the industrial and

agricultural sectors. Buyers who were willing to turn their capital into goods and materials at a time of commodity shortage and growing inflation were in an acute need of a trade-facilitating institution. An opportunity to sell excessive stock build-up in company warehouses through an exchange at market prices was yet another factor prompting proliferation of exchange trade. Hence the exchanges which began to appear in the early 1990s helped resolve these issues. Moreover, the exchanges themselves became entities into which surplus cash could be invested.

Russia

Economic reform and privatisation of state property at the beginning of the 1990s gave rise to a new class of private owners, which included many small and medium businesses. Tens of thousands of new joint stock companies, cooperatives and partnerships, municipal and individually-owned companies were formed.

The actively developing production sector demanded new markets and trade-facilitation institutions; new and existing companies sensed a sharp rise in demand for raw materials and finished products.

The Gosbank and Vneshekonombank currency auctions and the Gosstab commercial centres, which sold manufacturing supplies through auction sales at the end of the 1980s, formed the basis of the future commodity exchanges. The creation of the Moscow Commodity Exchange and the Russian Commodities and Raw Materials Exchange in the first half of 1990 marked the start of a commodity exchange boom in the Russian Federation. Russia propelled to the world capital city of exchanges in terms of the number of exchanges, with about

Table 12.7.
Main phases
of commodity
exchange
development in
Russia

Stage	Main characteristics	Main events
1990–1991	<p>A period of rapid growth in the number of exchanges and brokerage companies (see Figure 12.6). Exchanges were established in the form of for-profit commercial ventures.</p> <p>Initially, Russian exchanges were more akin to trade fair than to a modern commodity exchange.</p> <p>The exchange functioned as a centre for building cooperation ties on an array of commodities, goods and materials.</p> <p>Commodity trade was almost exclusively based on transactions involving cash commodities.</p> <p>Excessive exchange market with an over-abundance of intermediaries.</p>	<p>An unstable macroeconomic environment, uncertainty in economic relations and wholesale market prices fixed by the state encourage commodity exchanges to become universal.</p>

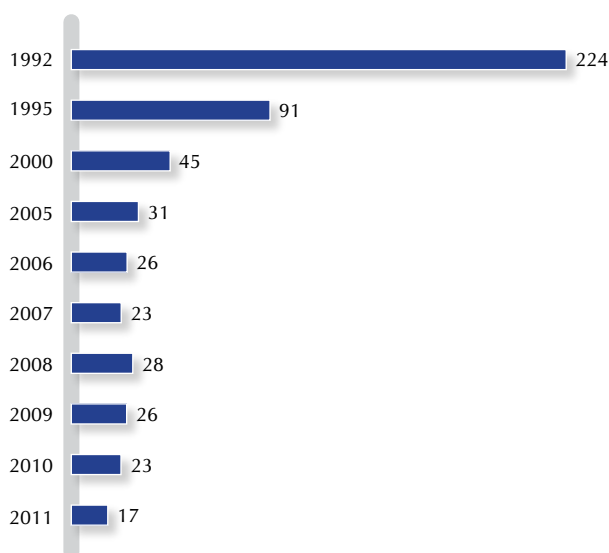
Stage	Main characteristics	Main events
1992-1994	<p>A period of reorganisation and decline in trading activity</p> <p>Exchange trade cleaned up of "quasi-exchanges". Competition between commodity exchanges and off-exchange structures intensified.</p> <p>Refinements to exchange trading procedures gathered momentum coupled with commodity market integration and concentration.</p> <p>Domestic exchanges began to specialise in certain commodities.</p> <p>The first forward contracts were traded. Futures trading were initially confined to commodities such as oil and petrochemical products, grain and non-ferrous metals.</p>	<p>1991 and 1992 saw the adoption of federal laws and regulations bringing the legal status of Russian exchanges in line with international standards. At this stage, stock markets were more in line with global practice than commodities markets. This tendency continues.</p> <p>The beginning of 1992 was a milestone for the Russian exchange market. Three powerful factors came into effect:</p> <ul style="list-style-type: none"> • introduction of free pricing; • new legislation on exchanges; • increase in taxation of brokering activities. <p>The advantages of free pricing were made available to all market participants. The exchange lost its exclusive rights and monopolistic position; profitability decreased.</p> <p>Together with price liberalisation and a tightening up of commodity exchange regulation, the tax burden on commodity exchanges also increased. As a result, commodity exchange trading diminished with trade shifting to off-exchange markets and brokering activities became much less attractive.</p> <p>The forward trading of grain and cotton began on the Moscow Commodity Exchange (MCE) and the Moscow Chamber of Commerce organised currency futures trading for the US dollar.</p>
1995-1996	<p>The introduction of electronic commodity exchange trading</p> <p>The commodity exchange has transformed from a trade fair where physical goods were sold into a computerised market of derivatives.</p> <p>Virtual trading replaced traditional commodity exchange trading and provided market participants with automated purchase/sale and settlement via remote terminal.</p>	<p>Wholesalers refined their trading practices, established stable commercial partnerships and started to abandon trading floors, so did cash flows. Exchange members began operating on off-exchange markets. Only those commodity exchanges which succeeded to established trade in futures contracts survived. By the end of 1993, the number of commodity exchanges had decreased by one third and by the end of 1996 had fallen to some 40% of the 1992 figure.</p> <p>The Moscow Commodity Exchange, the Moscow Non-ferrous Metals Exchange and other Russian exchanges began to adopt electronic trading systems. Virtual exchanges such as Grain On-line, the Russian Metallurgy Sector (rusmet.ru), the Ural Metals Market and a number of other electronic commodity exchange were created.</p> <p>Optimism among electronic commodity exchange market organisers during the late 1990s that the volume of trade would increase faded.</p> <p>The transformation of the Russian commodity exchanges into an online trading system coincided with similar changes worldwide; trade volumes on the leading exchanges increased due to improvements in settlement procedures and remote access networks. With greater liquidity and increased trade volumes, international commodity exchanges were becoming more attractive for both Russian and foreign market participants.</p> <p>Diminishing role of domestic commodity exchanges and increased competition led to (1) a fall in the number of foreign investors, buyers and sellers on Russian commodity exchanges; and (2) a reorientation of large Russian players in oil, agricultural and metal markets towards global exchanges.</p>

Stage	Main characteristics	Main events
1996–2000	A period of consolidation and integration on the commodity exchange markets and a decline in the volume of trading. Trade in futures contracts on the regular basis	By the beginning of the new millennium, commodity exchange trading has undergone a qualitative change, due to the introduction of electronic trading (see Figure 12.7). Commodity exchanges unable to make the necessary improvements to their trading process opted for restructuring into holding companies. The Russian Food Exchange, for example, reorganised into the Chekoviy Investment Privatisation Fund, the Russian Food Bank and a financial-industrial group. Mergers represented another way of reorganising. For example, a merger involving the Moscow Universal Exchange of Recoverable Resources, the Konversiya commodity exchange and the Forestry Exchange, led to the establishment of the Moscow Chamber of Commerce. RUIS-birzha merged with the Moscow Commodity Exchange. Many commodity exchanges entered similar arrangements.
2000–2011	Electronic exchange trading in commodity futures on Russian trading floors and the use of exchange pricing for gas and electricity	Gas exchange opened in Moscow in November 2006 and Moscow energy exchange Arena – in July 2007. In 2010, the government decided to channel trade in grain through commodity exchange. The decision was prompted by a severe drought and speculations which inflated prices for grain and cereals (see Figures 8, 9). This allowed the commodity exchange to become an institution protecting consumer rights through price competitiveness, eliminating the need for a long line of middlemen.

Source: : <http://vadim-galkin.ru/>, Stages in the development of the commodity market in Russia; September 29, 2011

Figure 12.6.
**Number of
exchanges**

Source: Federal State
Statistics Service
(FSSS), 2012; Federal
Antimonopoly
Service (FAS), 2012



40% of all the exchanges worldwide established in Russia. Since 1993, the numbers have been decreasing (see Figure 12.6).

The revival of Russian commodity exchange activity became one of the critical milestones in the transition of the centrally planned economy into the market

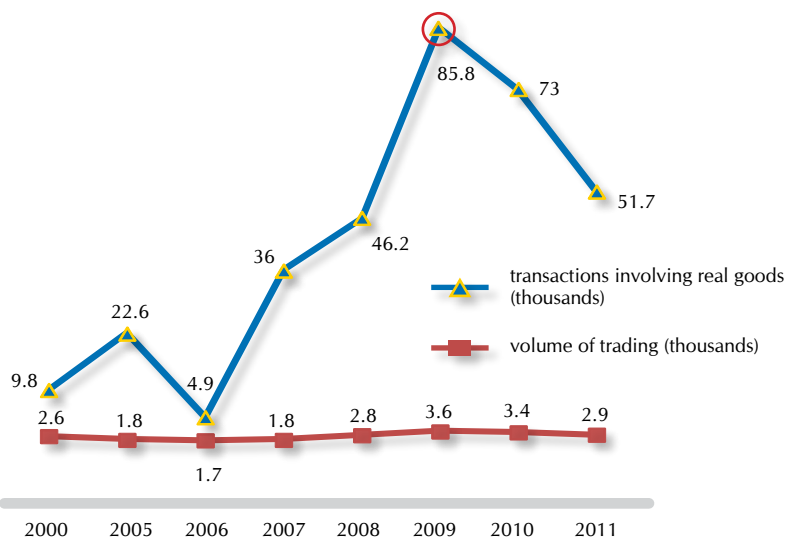


Figure 12.7.
Selected
performance
indicators of
Russian commodity
exchanges
(2000–2011)

Source: FSSS, 2012;
FAS, 2012

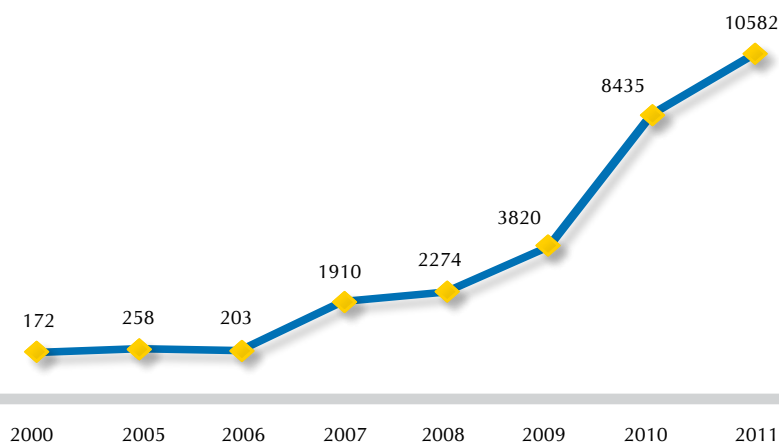


Figure 12.8.
Exchange turnover
in cash commodities
(excluding futures,
\$ million)

Source: FSSS, 2012;
FAS, 2012

system. Initially, with to the collapse of the state controlled supply system, exchanges took on the functions of trade-facilitation institutions. Investment, insurance and brokerage firms, trading houses and commercial banks grew up around commodity exchange structures. The commodity markets attracted capital, which was invested in business development and the creation of an information infrastructure. One of the commodity exchange's most important contributions was the formation of the country's first cadre of professional businessmen.

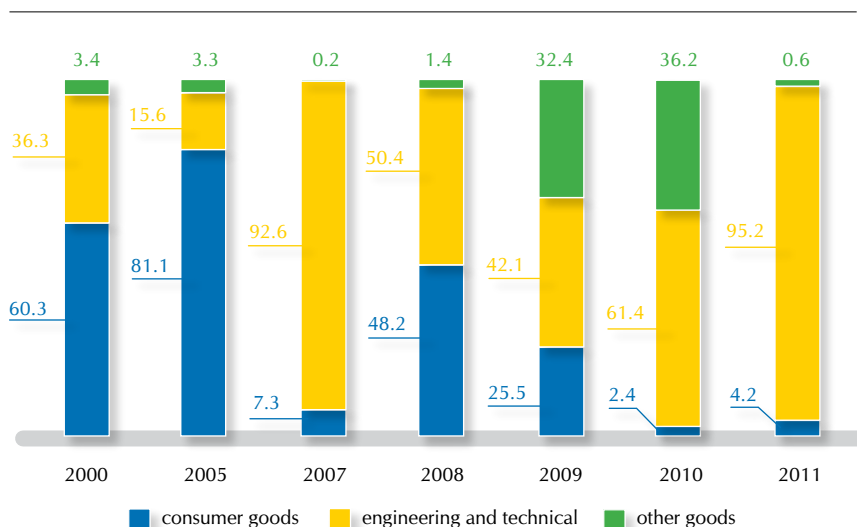


Figure 12.9.
Trade volumes by
type of operation
(2000-2011)

Source: FSSS, 2012;
FAS, 2012

These days, trading floor procedures became more streamlined and legislation on commodity exchange activity better aligned with international standards (Demchuk, 2006). Focus on international standards, use of foreign expertise in the working practices of exchanges and regulators and the proximity of highly developed and competitive foreign markets helped the Russian commodity market, despite its short history, develop in the mould of commodity markets in developed countries.

Kazakhstan

The prerequisites for the emergence of commodity exchanges and the development of goods and raw materials markets in Kazakhstan are similar to those of Russia. It should be noted that, in the early stages of their development, commodity markets in CIS countries were trading not only on their own floors, but also with other commodity exchanges in Central Asia and Kazakhstan (15 exchanges), the Siberian Ring consortium (16 exchanges in Russia), the Commodity Exchange Association of North West Russia and the Baltic (14 exchanges) using real time modem communication and intercom telephony.

In Kazakhstan, participation in commodity market trading has not yet reached the levels seen in the West and in Russia. Domestic organised commodity market is still shaping up. However, given Kazakhstan's significant potential in the agrarian and raw material sectors, the commodity exchange trade is considered as viable development instrument.

According to statistics compiled by the Ministry of Economic Development and Trade, Committee for Trade in Kazakhstan, the exchange trade in commodities

Table 12.8.

**Main events
in the development
of exchange trading
in Kazakhstan**

1991	June 13, 1991 – adoption of a special law on commodity exchanges in the Republic of Kazakhstan. Stock and commodity exchanges began to emerge, gaining organisational experience and conducting open and closed exchange trading in a wide range of goods and services, real estate and securities.
March 1994	The Presidential Decree of the Republic of Kazakhstan of March 20, 1994; no. 1604 "On Commodity Exchanges", supersedes the law adopted in 1991. Commodity exchanges, their objectives and primary functions were defined and extended.
April 1995	Exchange specialisation began, with separation into commodity and currency/stock exchanges. New Presidential Decree no. 2170 of the Republic of Kazakhstan of April 7, 1995 "On Commodity Exchanges" came into force and changed control of the market infrastructure. Under Resolution no. 1035 of the Cabinet of Ministers of the Republic of Kazakhstan of July 28, 1995, grain became an exchange commodity, complementing Law no. 2170 "On Commodity Exchanges" of April 7, 1995. The grain exchange was active in 1995-1997. The list of exchange commodities was extended to include agricultural products, hides, animal breeding products and manufacturing supplies (including petrochemical products, wood, ferrous and non-ferrous metals).
1996	Introduction of commodity exchange licensing. The Commodity Exchange Committee was legally appointed as the regulatory body, answerable to the Cabinet of Ministers.
December 1997	Trading activity declined due to exclusion of manufacturing supplies from the list of exchange commodities. Trading in other groups of exchange commodities became non-binding, especially in respect of exports.
May 2002	Commodity exchange activities resumed due to the state procurement of exchange commodities in open trading, in accordance with Republican Law no. 321 "On Public Procurement", adopted on May 16, 2002.
March 2004	New decrees adopted which further reduced the list of exchange commodities. Decline in market activity followed by the fall in the number of exchanges (see Figure 12.10).
2007	Head of State, Nursultan Nazarbayev, orders that measures be taken to develop the exchange market.
Autumn 2008	The exchange trading of grain in Kazakhstan virtually ceases in 2008; according to Ministry of Agriculture statistics, only 505,000 tonnes of grain were sold through the existing commodity exchanges.
December 9, 2008	JSC Commodity Exchange Eurasian Trading System was created by the order of the President of Kazakhstan, Nursultan Nazarbayev, and is 40% state-owned. Other participants were JSC Regional Financial Centre of Almaty and OJSC RTS Stock Exchange (Russian Trading System). The main purpose of this commodity exchange is to keep major commodity group prices transparent, reduce transaction costs and ensure fair prices for buyers and sellers. Exchange partner, RTS, one of the leading electronic trading platforms in Russia, contributes to ETS charter capital a range of software products used for futures and spot-market trading. ETS is now well placed to organise trading in line with international standards.

March 2009	Trade on the ETS agricultural section began on March 30, 2009. The trading floor hosted a wide range of players, represented by professional brokers trained by the exchange. The floor attracted participants from Turkey, Tajikistan, Iran and Uzbekistan. ETS has an up-to-date structure, including clearing and settlement facilities and is able to conduct electronic trading on a wide range of commodities. ETS is the only exchange in Kazakhstan conducting electronic trading to modern exchange industry standards.
May 2009	The new law no. 155-IV of the Republic of Kazakhstan of May 4, 2009 "On Commodity Exchanges" replaced the law of April 7, 1995 and established new principles and approaches to exchange trading. The law "On Commodity Exchanges" constitutes the right of the state to approve the list of exchange commodities and the minimum lots which are to be traded at commodity exchange only. This law regulated the activities of the commodity exchanges and was designed to rectify the insufficiencies accumulated in previously adopted legislation. The new law specifically addressed notions such as brokers, dealers and clearing and settlement centres. It also opened up opportunities for the introduction of modern trading technologies (e.g., online trading) and introduced a system of risk management.
November 2009	Resolution no. 1942 of November 26, 2009 established a licensing system for commodity exchange activity and the qualifications required to engage in commodity exchange operations and brokering.
December 2009	Model rules for exchange trading were approved by Resolution no. 2042 of the Government of Kazakhstan on December 8, 2009. At the same time new laws were adopted aimed at improving existing legislation on the state regulation and support of agrarian sector, in particular, the laws "On Grain" and "On State Regulation for the Development of Agriculture and Rural Territories". These amendments and additions to existing legislation were meant to increase state financial support and strengthen government regulation of the food market and the export of agricultural products.
April 2011	Government of the Republic of Kazakhstan Resolution no. 37 of April 6, 2011 established the list of exchange commodities and the minimum lots traded by the commodity exchanges. The list included potatoes, wheat, sugar, coal, cement and other commodities.
December 2012	Resolution no. 1653 of December 21, 2012 established qualifications requirements for commodity exchange operators, commodity exchange brokers and dealers.

has been gaining pace over the past three years. In 2011, total commodity exchange turnover amounted to around \$3 billion and trading activity on the commodity exchange amounted to 5% of wholesale turnover, compared with just 1% in 2010. The government creates favourable environment for exchange trade development, as an instrument to ensure transparency in the pricing of strategic commodities (Shaternikova, 2012).

In recent years the country has clearly made substantial efforts to develop commodity exchange mechanisms, but it would be premature to claim that there has been a system-wide introduction of modern instruments. Fragmentation of the legislation and regulation and insufficient enforcement are among the main reasons.

Nevertheless, the creation of the Eurasian Trading System commodity exchange in 2008 and the adoption of the "Law on the Commodity Exchange" in 2009 have laid the foundations for a new and dynamic commodity exchange in Kazakhstan (see Figures 12.11, 12.12).

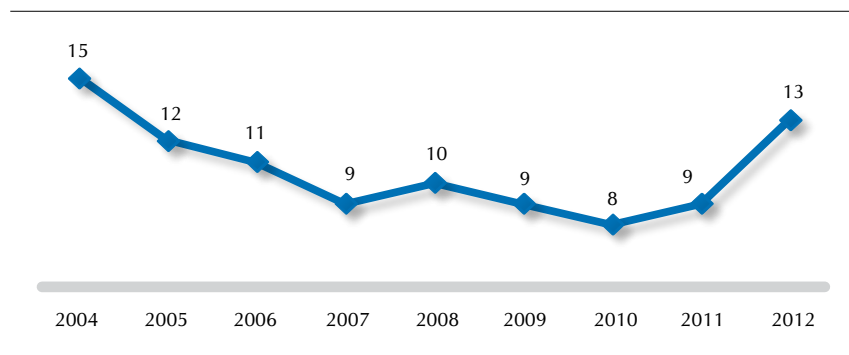


Figure 12.10.
Number
of commodity
exchanges
in Kazakhstan

Source: <http://www.stat.kz/digital/torg/Pages/default.aspx>

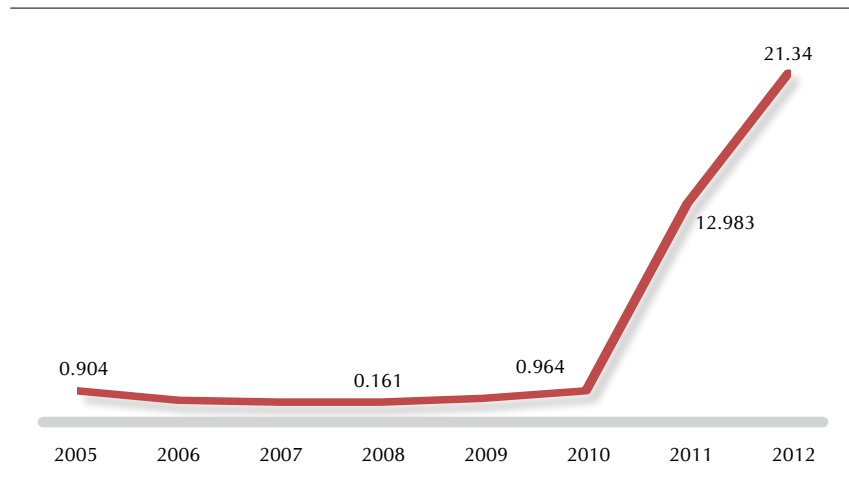


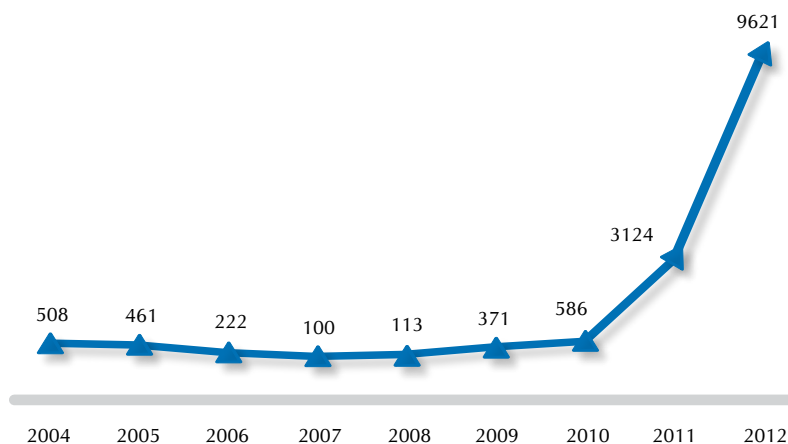
Figure 12.11.
Trade sessions
conducted
(thousands)

Source: <http://www.stat.kz/digital/torg/Pages/default.aspx>

There are certain similarities as well as differences in the development of the Russian and Kazakh commodity exchanges. One inherent similarity is the slow growth in commodity exchange activity, which could be attributed to state intervention. In Russia, this intervention took the form of stricter commodity market regulation and tax increases coinciding with price liberalisation in 1992. In Kazakhstan, as the commodity market evolved, permanent legislative

Figure 12.12.
Volume
of transactions
(\$ million)

Source: <http://www.stat.kz/digital/torg/Pages/default.aspx>



amendments became a barrier for set up of the level playing field. In both countries, the state has maintained zealous oversight of commodity exchanges in the absence of a comprehensive support programme for the sector.

Another similarity between the countries is the insufficient attention to develop the same level of infrastructure and regulation for commodity exchanges as exists for the stock market or banking sector. State participation in commodity exchange is an important factor of commodity market development. This was the case for Russia, but in Kazakhstan the first commodity exchange with the state participation appeared only in 2008.

Just as Russian commodity exchanges were beginning to adjust to the changing economic environment and were forging ahead with electronic trading for forward contracts, in Kazakhstan these processes had stalled at the real commodity trading stage. Moreover, the Kazakh government decided to stimulate trade by introducing a list of commodities that could only be traded according to established procedures.

There have been occasions in the history of the Kazakh commodity exchange when the creation of a wheat exchange would have improved grain trading and changed the landscape of this sector significantly, allowing the potential of the commodity exchange mechanism to be fully realised. But in 2008, grain trading on the Kazakh commodity exchange came to a virtual standstill.

Arguably one of the prominent differences between Russia and Kazakhstan has been the patent lack of economic incentive in developing Kazakh exchange market. Transactions on the commodity exchanges had long meant little more than getting a stamp for contracts negotiated outside the exchange, marking the contract with yesterday's date concluded at open outcry trade session.

Market development, competition, the introduction of new instruments and electronic trading have all made the Russian market what it is today. Kazakhstan lags behind Russia in all these aspects, but the Kazakh market is growing and the outlook is good.

These comparisons could be supplemented with the information from other CIS countries. And while the data collected by the CIS Statistical Committee contains plenty of gaps, it nevertheless gives an idea of a size of an organised commodity market in CIS.

	Number of exchanges operating at the year-end		Number of transactions concluded during the year (000s)	
	2009	2010	2009	2010
Kazakhstan	9	8	1.1	10.4
Russia	26	23	85.8	73
Ukraine	343	339	383	88

Table 12.9.
Performance of commodity exchanges in Kazakhstan, Russia and Ukraine (2009 – 2010)

Source: Source: <http://www.stat.kz/digital/torg/Pages/default.aspx>

On February 14, 2012, Kommersant Ukraine, referring to the Concept for Development of the Ukraine Commodity Market, reported that some 500 commodity exchanges operated in the country. However, the annual turnover of the Ukrainian commodity exchange market ranged between 5 billion and 8 billion grivna, a sum approximately equal to single trade session volume at Chicago Mercantile Exchange or NYSE Euronext.

The year 2010 marked the growth of exchange trade in Kazakhstan, linked, in particular, to the launch of the grain spot trade on the ETS commodity

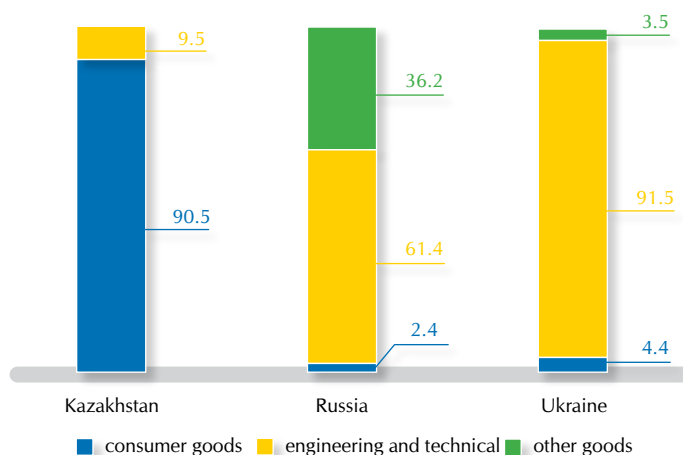


Figure 12.13.
Trade volumes by type of operation (2010)

Source: of the CIS Statistical Committee on stock, commodity and currency exchanges

exchange. The dominant share of consumer goods in total exchange turnover in Kazakhstan proves this. In Russia and Ukraine, manufacturing supplies account for the major share in turnover.

Commodity market development is on the reform agenda of practically all CIS countries. The results of a joint study by the Eurasian Development Bank and the International Association of Exchanges of CIS countries (IAE CIS) will be discussed in the next section. Based on a comparative analysis of national legislation in Russia, Kazakhstan, Belarus and Ukraine the study suggests that formation of a regional organised commodity market could improve the competitiveness of national commodity markets of these countries.

SES COUNTRIES ON ORGANISED COMMODITY MARKETS

Establishment of common commodity market of Russia, Kazakhstan and Belarus in the form of the Customs Union (CU) and enhanced opportunities to boost mutual trade suggest the next step in the advancement of integration agenda, i.e. addressing the issues of CU member-countries' cooperation in the organised commodity markets.

The political significance of the CU and SES formation influenced the ambitious deadlines for this project. Thus, certain issues were not sufficiently reflected in the general vision formulated in basic agreements of December 9, 2010, which provided the framework for effective functioning of the common (domestic) goods, services and capital markets. In 2010, for example, the establishment of the Eurasian agrarian exchange was announced. It was envisaged as a common exchange platform for Russian, Belorussian and Kazakh producers and consumers of agricultural products (IDK-Expert, 2010). However, the idea did not receive a warm welcome from commodity sector participants. Insufficient attention to the specifics of interaction in commodity markets resulted in project never came into being.

In November 2011, the Committee on Commodities Markets was established within the International Association of Exchanges of the CIS. Belarus Universal Commodity Exchange, Moscow Exchange, Saint Petersburg International Commodity and Raw Materials Exchange, Uzbek Republican Commodity and Raw Materials Exchange, Ukraine Interbank Currency Exchange, Moldova Stock Exchange, ETS Commodity Exchange and International Commodity Exchange of Kazakhstan became the first members of the Committee. It aims to develop a model of commodities markets regional integration for the CIS and EurAsEC countries; elaborate approaches toward harmonisation of regulation of national commodities markets and development of a common infrastructure for commodity market.

Although the share of exchanges in the total volume of wholesale trade in the SES is small yet, the region is in need of a modern commodity exchange. The SES members, as exporting countries with profound raw-material and agrarian

capacities, require more effective and transparent price setting mechanisms domestically.

Identification of constraints would be a starting point in the comprehensive discussion of the scope of SES countries' cooperation in the organised commodity markets. The EDB and IAE CIS reviewed these impediments in a comparative study of commodity exchange regulation in Russia, Belarus, Kazakhstan, Ukraine, Moldova, and Uzbekistan. For the purposes of this article only selected findings will be presented for Russia, Belarus, Kazakhstan and Ukraine:

Government support for the development of an organised commodity market

State support for organised commodity markets in SES+ countries is being offered under widely differing conditions.

In Russia, according to data published on the official website of the Federal Service for Financial Markets, there were 13 exchanges on the Russian Commodity Market on October 26, 2012 licensed to organise trading and 386 organisations with an exchange intermediary licences to perform commodity futures and options transactions in exchange trading.

In Kazakhstan, according to the Committee on Trade of the Ministry of Economic Development and Trade a total of 18 commodity exchanges and 445 commodity brokers and dealers were in operation as of September 1, 2012.

In Belarus, state regulation is focused on developing the BUCE, which is granted a special status on the commodity market. The BUCE has a total of 88 accredited brokers.

Ukraine is preoccupied with creating favourable environment for the grain market development and institutionalising the legal status of the Agrarian Exchange. There are more than 500 registered commodity exchanges in Ukraine.

Belarus, therefore, has only one commodity exchange and government legislation is formulated according to its experience and needs. Russia advances in unification of legislation on futures market on commodity and stock markets, as adopted under the federal laws "On Organised Trading" (no. 25-FZ of November 21, 2011) and "On Clearing and Clearing Activity" (no. 7-FZ of February 7, 2011). At present, specifics of commodity exchange trading signals the importance of single regulator for this sector.

In Kazakhstan, organised commodity market is separated from securities market. At the level of government regulation the definition of futures and options concur for both markets, and this creates a lot of collisions. For example, licensing is compulsory for the performance of clearing activities on financial instruments

on the securities market, but no such requirement exist for the commodity market. In accordance with the Civil Code of the Republic of Kazakhstan and the law “On Commodity Exchanges” (no. 155-IV of May 4, 2009), commodity exchanges have the right to trade futures and options, which are referred to as derivative financial instruments. In addition, the stock market government regulator and respective legislation is more developed in comparison to the organised commodities market. This is an obstacle to the normal interaction between these separate markets and is, in fact, one of the major stumbling blocks in the development of the futures and organised commodities market in Kazakhstan.

Regulation of the organised commodity market in Ukraine is highly fragmented. Division by sectors of economy result in multiplicity of by-laws from different line ministries and agencies.

Regulatory framework and national regulator

Regulatory framework consists of the national legislative acts and internal rules and procedures of individual commodity exchanges. Almost all of the countries have laws on commodity exchange and on electronic digital signature. Russia is more advanced with the laws such as on clearing and clearing activity, on licensing of certain types of operations, on organised trade. Ukraine does not have a specialised public agency discharging regulatory functions of the organised commodity market. In Kazakhstan regulation is exercised by the Committee on Trade within the Ministry of Economic Development and Trade; and in Russia regulatory functions rest with the Federal Service on Financial Markets. In Belarus regulatory framework is multilayered, consisting of the President Lukashenko, Council of Ministers, Ministry of Trade and interministerial Coordination Council. Legislation initiative comes from the Ministry of Trade.

Findings on regulatory framework:

1. In Belarus commodity exchange was created with the direct state participation. Existing by-laws provide detailed regulation of many aspects of commodity exchange operations and a well developed exchange infrastructure already exists. Belarus Universal Commodity Exchange (BUCE) effectively develops supply logistics and commodity exchange infrastructure, including warehouse facilities. BUCE has a network of foreign representative offices.
2. Russian legislation is being amended actively to reflect the development trends in the organised commodity markets. Changes include the strengthening of counterparty risk guarantees, convergence of regulation on forward contract trading, clearing and settlement on stock and commodity markets.

3. Kazakh legislation on the regulation of organised commodity markets underwent important qualitative changes in 2009–2012. However, separate regulation of trade in derivatives on stock and commodity exchanges revealed drawbacks of such an approach with respect to trade in futures and options on commodity exchange. A uniform approach to the regulation of transactions in financial instruments on both markets may be recommended.
4. In Ukraine the development of regulatory framework, both at the government level and at the level of exchanges' internal rules and procedures, lags behind other studied countries in terms of scope and depth of regulation.

Regulatory restrictions

In each country respective state regulation mounts certain restrictions on the organiser, participants of exchange trade and commodities traded. Kazakhstan, Russia and Belarus do not recognise licenses of non-resident brokers and dealers and they are not admitted to trade. Kazakhstan, as support measure, has list of commodities to be traded on exchange only. Belarus has a practice of setting minimal prices on selected export commodities. More so, the exchange sets the price corridor (level of min and max price) for exchange commodities. In Ukraine trading in grain only takes place on exchanges which are accredited by the Ukrainian Ministry of Agriculture.

Findings on regulatory restrictions:

1. In all the SES+ countries, with the exception of Russia, clearing activities in respect of transactions (including futures contracts) on commodity exchanges is not subject to licensing. Accordingly, no charter capital requirements are applied to clearing organisations, to qualification of their employees, and to information technologies used thereof. Furthermore, it is not required to separate clearing centres from commodity exchange structure in Kazakhstan, Belarus and Ukraine.
2. At the same time, the law on commodity exchange in all the countries forbids participation of commodity exchanges in trading, conclusion of transactions in the name of the commodity exchange and at the expense of exchange's means, and to engage in trading and intermediary operations. This effectively means that no one exchange in any of these countries can organise valid forward trading without engagement of the third-party, as the exchange itself has no right to perform as central counterparty agent. The third-party organisations can be established by the exchange, with its participation or be contracted by an exchange. However, in the absence of legal requirements to counterparty agent organisations, it unlikely that would be possible to ensure adequate levels of risk for participants.

3. Russian legislation already prohibits the exchange from acting in the capacity of central counterparty agent.
4. The term “central counterparty agent” currently appears in Russian and Kazakh legislation only; without such a key participant, the development of futures markets is next to impossible.

Settlement of export/import exchange transactions and currency regulation

The settlement of export/import exchange operations is governed by provisions of national legislations on foreign trade.

1. In Russia and Kazakhstan, regulation of export trade and foreign exchange remains detached from the legislation on organised commodity market. Foreign exchange legislation in the Republic of Kazakhstan does not take into consideration the specific nature of transactions concluded on commodity exchanges. Commodity exchanges and clearing centres cannot facilitate as guarantee in settlements between the clients. Current legislation on foreign exchange does not permit transfers in currencies other than domestic, thus all the transfers have to be converted in local currency.
2. Foreign exchange regulation in Belarus and Ukraine contains provisions that take into account the specific of settlement operations and offers a possibility to use a special commodity exchange account for participation in settlements. Approaches are country-specific, but export contracts concluded on commodity exchange are not exempt from requirements and procedures established by foreign trade legislation. The respective documentation is completed by brokers on behalf of their clients.

Taxation of exchange transactions

Participants of exchange trade are taxed in the order prescribed by the national legislation and international agreements, ratified by each of the countries studied. International agreements between the CU member states came into force on July 1, 2010 regulating VAT on imports and exports, works carried out and services rendered, and VAT administration in mutual trade. At present the varying value-added tax rate (18% in Russia; 20% in Belarus; 12% in Kazakhstan) and excise tax on petrol and diesel applied by Russia and Ukraine create certain complications for international exchange transactions.

Commodity futures trade as part of an organised commodity market

The futures market is at a different stage of development in each of the countries studied. A revival in commodity markets began in 2008. Many commodity exchanges had chosen to develop futures markets without linking contract to the price of underlying assets. As a result, market did not attract real participants and the process of establishing a futures market stalled.

Gradually joint efforts of brokers, commodity exchanges and banks generated positive changes for the development of a futures market. In Russia futures market has started to attract financial investors, and thus liquidity and trade volume are increasing. Kazakhstan's ETC is attempting to launch trade in futures. In Belarus, first trading in commodity futures on BUCE marked the end of 2012. The main problem encountered by BUCE was low awareness of participants of such an instrument.

The futures section of the Ukrainian exchange was launched on May 27, 2010 with the futures contract on UX Index. Within a few months, it became the Ukrainian stock market's most liquid instrument. A year later, on April 26, 2011, another derivative instrument was launched – option contract on UX futures. There is no trading of futures contracts on the commodity exchange.

Findings on futures market:

1. Even the legal attribution of futures contracts is dealt with in a different ways by commodity exchanges of studied countries:
 - In Russia, futures are treated as financial instruments. This is a result of a transition to a more unified regulation which implies similar treatment of transactions on both commodity or stock exchange; common requirements to the organisers of commodity and stock trade; government regulation and control.
 - In Kazakhstan, futures are classified as financial derivatives. As such, futures fall under the stock market and stock exchange regulation and the commodity market and commodity exchange regulation accordingly. At present there is a significant difference between these two sets of legislation, which causes numerous hindrances to the development of commodity futures market.
 - In Belarus, commodity exchange traded futures are not regarded as securities.
 - Ukrainian legislation does not provide for a futures contract as a transaction on commodity exchange. It is covered by the definition of an individual security, as defined in the Ukrainian Civil Code. Thus the regulation of futures market falls under the legislation on the stock market.

MAIN CONCLUSIONS

The research has shown that national commodity market regulation in Russia, Kazakhstan, Belarus and Ukraine is hindering inter-exchange cooperation on organised commodity markets.

1. Existing legislation in SES countries and Ukraine is not conducive to international cooperation among exchanges. Varying levels of coverage

and depth of national regulation on commodity markets and exchanges in these countries impose barriers for harmonisation of regulation.

2. Legal barriers to the participation of foreign legal entities and individuals in commodity exchange trading are incorporated in the national legislation of the majority of the countries studied. In countries where such provisions do exist, they cannot be implemented nonetheless owing to conditions stipulated in by-laws.
3. Settlement procedures on import/export contracts, currency regulation and clearing/settlement procedures for commodity exchange transactions differ in each of the participating countries.
4. There is no mechanism for mutual acceptance of electronic digital signatures, even where national legislation has provisions to this matter.
5. Each of the participating countries has made significant efforts to guarantee transaction obligations by counterparties and to develop infrastructure and supply logistics. However, meaningful international cooperation on commodity market requires a unified approach to regulation in these spheres.

It is now time for defining and adopting priorities for the development of an organised interstate commodity exchange. This will require a more detailed analysis of the constraints that affect such cooperation and development of a long-term strategy to create a competitive SES interstate commodity market. It is clear that the differences in legislation on organised commodity trade are a serious barrier to interexchange cooperation. As already mentioned, the regulation of organised commodity markets is much less elaborate than that of the stock markets or the banking sector.

The results of comparative analysis of the legislation of organised commodities market in SES countries could be used to develop a comprehensive commodity exchange model for SES countries, based on common principles of operation, provision of access to professional participants, regulation, trading floor procedures and size of assets, information transparency, contract guarantees and risk management.

A large number of issues will need to be addressed in order to achieve the necessary level of legislative unification between the member states. This will require collaborative efforts by regulators, commodity exchanges, industry association and other stakeholders. A special oversight authority dedicated to the sector should be created to coordinate development efforts in the organised commodity market, similar to those established for the stock markets in the CIS and EurAsEC regional organisations.

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Mechanical Engineering in the Single Economic Space of Russia, Kazakhstan and Belarus

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In December 2012, the Eurasian Development Bank in cooperation with the Institute of Economic Forecasting of the Russian Academy of Sciences (IEF RAS) published a sector report called “Mechanical Engineering in the EDB Member States”. This article presents the main findings of the study with an analysis of the current situation and prospects for the integration of mechanical engineering in the Single Economic Space (SES) of Belarus, Kazakhstan and Russia.

Mechanical engineering is the most important sector in the economy of any industrially developed country and includes the production of various types of equipment, machinery, tools, appliances and consumer goods. Mechanical engineering primarily relates to the processing industries: it embraces agriculture, energy, metallurgy, transportation and other sectors of the economy, and underpins the stability of their operations.

Sustainable development and the consistent operation of the sector largely determine the energy capacity and material output of the economy, not to mention labour productivity, the level of ecological safety, competitive industrial production and, ultimately, the economic security of the country. These indicators are the most important factors for the successful economic development of a region, and no less in the SES. Due to the three member states’ increased integration, the development of mechanical engineering is becoming the core driver of successful development of the SES as a whole.

CURRENT SITUATION IN THE SECTOR

In the post-Soviet period of economic development, until the year 2000, mechanical engineering in the SES countries was in sharp decline. A period of growth ensued, although this was brought to an end by the financial crisis of 2008.

The relatively rapid growth of mechanical engineering output since 2010 bears witness to the potential for development in the sector. However, these rates are significantly lower than the growth in demand, which is currently being met by imports.

Looking to the future, the sector is in need of effective development. The task facing all the SES countries is to maintain and develop mechanical engineering potential while replacing the need for import of basic products (import substitution industrialisation).

In what follows, the term “mechanical engineering” is understood to mean the combination of three types of economic activity: the production of machinery and mechanical equipment (hereinafter referred to as “equipment”), the production of electrical, electronic and optical equipment (hereinafter “electrical equipment”) and the production of means of transport and associated equipment (hereinafter “transport facilities”). The production of arms, ammunition and military hardware is not included.

The position of mechanical engineering in the economic structure of the SES varies among the member countries. In Kazakhstan, it accounts for just 0.6% of gross value added, whereas in Russia the equivalent figure is 2.9% (see Table 13.1). This is, however, relatively small in comparison to leading manufacturing countries. In Germany, for example, manufacturing accounts for 8.1% of gross value added and in Japan – 7.2%. Only in Belarus is the figure comparable with those of Germany and Japan, at 7.1% of value added.

Table 13.1.

**Mechanical
engineering gross
value added (% gross
value added)**

	Russia	Belarus	Kazakhstan	Germany	USA	Japan
Mechanical engineering	2.9	7.1	0.6	8.1	4	7.2
Equipment production	0.9	3.6	0.3	3	1	1.9
Electrical equipment production	0.9	1.9	0.2	2.5	2.1	2.9
Transport facility production	1.1	1.6	0.1	2.6	0.9	2.4

Source: Rosstat, Belstat, Statistical Agency of the Republic of Kazakhstan, Eurostat, US Bureau of Economic Analysis, Statistics Bureau of Japan, IEF RAS estimates

Note: The data for Russia relates to 2011, the data for Belarus, Kazakhstan and USA relates to 2010 and that for Germany and Japan to 2009. For the USA, gross domestic product is expressed as % GDP.

The mechanical engineering sectors of the SES countries also vary markedly by structure, and are worth investigating separately.

Russia

In Russia, machinery and equipment production and the automobile industry are the main subsectors. However, the country is well behind the global leaders Germany and Japan, both in respect of volume of production (as the low volume of Russian mechanical engineering exports suggests) and the quality of products manufactured.

In 2011, the contributions of Russia's largest mechanical engineering subsector – equipment production and automobile, trailer and semi-trailer production – totalled 24.7% and 27.9% respectively (see Table 13.2).

The contributions of electrical equipment and aircraft production (including spacecraft) lay in the range 9.8–12%, while railway rolling stock, medical equipment, electronic components, shipbuilding and ship repair lay in the range 3.8–7.8%. The volume of computer and office equipment production in Russia is not large – its contribution to mechanical engineering output is just 1.4% in total.

Between 2006 and 2011, the structure of Russian mechanical engineering did not undergo any significant changes. The main difference was a reduction of 2.4% in equipment manufacturing. The contribution of rolling stock production increased to 1.8%, but the contributions of the other types of mechanical engineering activity did not exceed 1.3%.

	2006	2011
Mechanical engineering – total	100	100
Equipment production (excluding the production of arms and ammunition)	27.1	24.7
Production of office equipment and computer technology	1.4	1.4
Electrical equipment production	13.1	12
Production of electronic components, radio apparatus, television and telecommunications equipment	5.7	5.7
Production of medical equipment; measuring, monitoring, test and control equipment; optical devices, photographic and cinematographic equipment; clocks and watches	6.6	7
Production of motor vehicles, trailers and semi-trailers	26.8	27.9
Shipbuilding and ship repair	4.8	3.8
Aircraft production, including spacecraft	8.5	9.8
Production of railway rolling stock, other transport facilities and equipment	6	7.8

Table 13.2.
The structure of
Russian mechanical
engineering output
by type of economic
activity (%)

Source: Rosstat, IEF
RAS estimates

Russian mechanical engineering value balances by type of economic activity can describe the current state of mechanical engineering. When calculating

balances, the six-figure foreign economic activity commodity nomenclature (FEACN) is re-grouped into the all-Russian classifier of types of economic activity (OKVED).

In 2011, Russia exported 0.49 trillion roubles (\$16.7 billion) of mechanical engineering products – 10% of total mechanical engineering output (see Table 13.3). At the same time, the volume of imports was practically identical to output at 4.48 trillion roubles (\$152.4 billion). In 2011, the total demand for manufactured goods within Russia amounted to 8.87 trillion roubles (\$301.8 billion), a little more than half of which was met by imports.

For the majority of economic activities, the export-weighted average is generally no more than 15% of output volume. The exceptions are: bearings, toothed gears and parts for mechanical gears and drives, the export of which amounts to 34.5% (although output is relatively low for this type of activity), shipbuilding and ship repair – at 25.9%, electronic components, radio apparatus, television and telecommunications equipment at 20.9% and aircraft (including spacecraft) at 19.2%. It can be assumed from these figures that Russian mechanical engineering output is not in great demand on global markets.

At the same time, foreign-manufactured engineering products are in heavy demand on the Russian market for most types of economic activity. For example, in 2011, imports were able to satisfy 80.2% of internal demand for office equipment and computers, machine tools (79.4%), medical equipment (74.4%), machinery and equipment for agriculture (77.3%), electronic components, radio apparatus, television and telecommunications equipment (71%), and bearings, toothed gears and parts for mechanical gears and drives (65.5%). The Russian economy's dependence on foreign imports across such a diverse range of engineering goods is an alarm call.

A better balance between demand for domestically produced and imported goods was achieved in the engines and turbine production subsector, with only 13.2% of demand in 2011 being met by imports. For the production of domestic appliances, this figure amounted to 31.3%; for equipment for the metallurgical industry – 32.5%; for electrical equipment – 37.5%; and for measuring equipment – 30.7%.

In the transport facilities subsector, imported products satisfied 42.1% of demand. Foreign suppliers satisfied 52.7% of the demand for automobile internal combustion engines, 37.7% and 27.4% of the demand for motor cars and trucks respectively; 20.6% of the demand for buses and trolleybuses; and 23.3% of the demand for railway rolling stock.

Taken as a whole, Russian mechanical engineering is almost completely focused on its internal market, although the sector is actually unable to satisfy much of the demand from the Russian market. As a result, this demand has to be met by imports.

Table 13.3.
Russian mechanical engineering value
balances for 2011

	Output (trillion roubles)	Exports (trillion roubles)	Imports (trillion roubles)	Consumption (trillion roubles)	Demand satisfied by imports (%)	Exports (% of output)
Mechanical engineering	4.88	0.49	4.48	8.87	50.5	10
Equipment production	1.21	0.1	1.58	2.68	58.9	8.5
Production of turbines and engines, excluding aircraft, rocket, motor vehicle and motor cycle engines	0.13	0.01	0.02	0.14	13.2	4.6
Production of bearings, toothed gears and parts for mechanical transmissions and drives	0.03	0.01	0.03	0.05	65.5	34.5
Production of agricultural machinery and equipment	0.05	0	0.17	0.21	77.3	8.5
Machine tool production	0.02	0	0.07	0.09	79.4	14
Production of lift equipment	0.09	0	0.09	0.17	51.7	3.8
Production of machinery and equipment for the metallurgical industry	0.07	0	0.03	0.1	32.5	2.3
Production of machinery and equipment for the construction and resource extraction industries	0.12	0.01	0.18	0.29	62.8	11.3
Production of domestic appliances not included in other product categories (refrigerators, freezers, washing machines, dish washers, microwave ovens, etc.)	0.12	0	0.06	0.18	31.3	1.8
Electrical equipment production	1.27	0.15	1.33	2.44	54.3	12
Production of office equipment and computer technology	0.07	0.01	0.23	0.29	80.2	12
Production of electrical machinery and equipment	0.59	0.05	0.32	0.86	37.5	8.3
Production of medical equipment, including surgical equipment and orthopaedic appliances	0.05	0	0.12	0.16	74.4	7.8
Production of electronic components, radio apparatus, television and telecommunications equipment	0.28	0.06	0.53	0.75	71	20.9
Production of measuring, monitoring, control and test equipment; optical devices, photographic and cinematographic equipment; clocks and watches	0.3	0.03	0.12	0.38	30.7	11.6
Production of transport facilities and equipment	2.4	0.23	1.57	3.74	42.1	9.7
Production of internal combustion engines for motor vehicles	0.1	0.01	0.09	0.17	52.7	13.8
Motor car production	0.92	0.02	0.55	1.46	37.7	1.7

	Output (trillion roubles)	Exports (trillion roubles)	Imports (trillion roubles)	Consumption (trillion roubles)	Demand satisfied by imports (%)	Exports (% of output)
Bus and trolleybus production	0.06	0	0.01	0.07	20.6	3.7
Truck production	0.29	0.01	0.1	0.38	27.4	3.5
Shipbuilding and ship repair	0.18	0.05	0.11	0.25	45.5	25.9
Railway rolling stock production	0.38	0.02	0.11	0.46	23.3	6.4
Aircraft production, including spacecraft	0.48	0.09	0.17	0.56	30.4	19.2

Source: Rosstat, UN Statistics Division, Institute of Economic Forecasting RAS estimates

Note: The output estimates for 2011 given in the table are based on the data obtained per OKVED class for 2011 and the output structure of the various OKVED groups and sub-classes for 2010 taken from Rosstat Form no. 1 "Companies". Export/import estimates in roubles were calculated using average annual dollar-rouble exchange rates. Consumption is taken to mean the sum of total output and total imports. Exports are not included

Belarus

In 2011, mechanical engineering output in Belarus in monetary terms amounted to 58.7 trillion Belarusian roubles, equivalent to \$12.7 billion (see Table 13.4). Of that output volume, 46.3% was accounted for by machinery and equipment production (primarily agricultural equipment), 32.4% by transport facilities and associated equipment and 21.3% by electrical equipment.

In 2011, exports accounted for 65% of all mechanical engineering output in Belarus. Of the total transport facilities produced, 71.3% is exported, while 66.2% of equipment and a little over half of electrical equipment produced is exported. Imports satisfied 70% of the demand for mechanical engineering output and the same figure was recorded for the transport facilities subsector.

Generally, mechanical engineering in Belarus is relatively advanced, particularly with regard to agriculture and transportation (see Table 13.4). For example, Belarus produces over 59,000 tractors, 2,000 combine harvesters, 22,000 trucks and 2,000 buses per annum. In addition, current output includes the

Table 13.4.
Mechanical
engineering market
balances in Belarus
(2011)

	Output (trillion Belarusian roubles)	Exports (trillion Belarusian roubles)	Imports (trillion Belarusian roubles)	Demand satisfied by imports (%)	Exports (% of output)
Mechanical engineering	58.7	38.2	48.3	70.1	65
Production of equipment	27.2	18	21.9	70.4	66.2
Production of electrical equipment	12.5	6.6	14.5	70.9	52.7
Production of transport facilities	19	13.5	11.9	68.6	71.3

Source: Belstat, UN
Statistics Division,
Institute of Economic
Forecasting RAS
estimates

production of domestic appliances, such as refrigerators, washing machines and televisions.

Both monetary and physical indices illustrate the relatively high level of development of mechanical engineering in Belarus. This also ensures that production is not only in demand within Belarus itself, but also on foreign markets such as Russia and Kazakhstan. However, due to the relatively small size of Belarus's economy, mechanical engineering is also limited in scale and not able to satisfy internal demand for every type of product. Consequently, the country is forced to import a significant volume of mechanical engineering products.

Kazakhstan

Kazakhstan's mechanical engineering is oriented towards the mining and metallurgical, oil and gas, agricultural and transportation production sectors.

In 2011, mechanical engineering output in Kazakhstan (excluding data for the installation and repair of transport facilities) amounted to 278.2 billion tenge (\$1.9 billion) or 1.7% of total industrial output (see Table 13.5). Equipment accounted for 27.8% of total mechanical engineering output, with electrical equipment accounting for 31.3% and transport facilities for 40.9%.

Kazakhstan's internal demand for mechanical engineering production is very much dependent on imports: 92.1% of manufacturing engineering consumption is covered by supply from abroad.

The chief characteristic of mechanical engineering in Kazakhstan is the predominance of assembly plants in the vehicle construction, railway and agricultural subsectors.

The main area of future growth in mechanical engineering in Kazakhstan is likely to be the transport sector. The number of new vehicle, electric and diesel locomotive assembly plants in the country is growing. In the near future, railway mechanical engineering will start operating at a scale sufficient to supplement and replace existing rolling stock.

Table 13.5.
Mechanical engineering in Kazakhstan (2011)

	Output* (billion tenge)	Exports (billion tenge)	Imports (billion tenge)	Demand satisfied by imports (%)	Exports (% of output)
Mechanical engineering	278.2**	102.6	2037.7	92.1	36.9
Production equipment	77.4	51.3	809.2	96.9	66.3
Production of electrical equipment	87	42.5	735.9	94.3	48.9
Production of transport facilities	113.8	8.8	492.6	82.4	7.7

Source: Statistical Agency of the Republic of Kazakhstan, Customs Union Commission, UN Statistics Division, IEF RAS estimates

Note: *Volume of production at current prices. **Excluding production figures for the machinery and equipment repair and installation subsector

MECHANICAL ENGINEERING IMPORT AND EXPORT

All the SES countries remained net importers of mechanical engineering products during the period under review. In Russia, Belarus and Kazakhstan, dependence on mechanical engineering imports increased. During 2006–2011, Russian mechanical engineering exports grew by 29% (total exports in the 84–90 FEACN group in US dollars), while imports grew by 123%. In Belarus, the growth in exports was 85%, while imports totalled 96%. In Kazakhstan, exports grew by 4%, and imports increased by 30% over the same period.

In 2011, the majority of mechanical engineering exports from the SES countries went to Russia – \$16.6 billion (see Table 13.6). Mechanical engineering exports from Belarus accounted for \$6.8 billion, while exports from Kazakhstan totalled \$0.7 billion.

An analogous situation exists with respect to imports, with the significant exception, however, of Russia: Russian imports of mechanical engineering production amounted to \$152.4 billion in 2011, significantly higher than the other two member countries (Kazakhstan's imports amounted to \$13.9 billion, while those of Belarus made up \$8.6 billion).

All the SES countries are net importers of mechanical engineering products, yet only Belarus has comparable export and import figures. In the other countries, the costs related to importing machinery, equipment and means of transportation are some 8–20 times greater than the sums earned from exports (in Russia, the ratio is 9).

Table 13.6.
Mechanical
engineering exports
and imports in the
SES countries in
2011*

	Mechanical engineering output (\$ billion)		Percentage of operations with mechanical engineering output				
			Total volume of operations involving country member (%)		GDP of the country member (%)		
	exports	imports	exports	imports	exports	imports	net exports
Russia	16.6	152.4	3.2	49.9	0.9	-8.2	-7.3
Belarus	6.8	8.6	16.9	18.8	13.9	-17.6	-3.7
Kazakhstan	0.7	13.9	0.8	26.6	0.4	-7.6	-7.2

Source: Customs Union Commission, UN Statistics Division, Rosstat, Belstat, Statistical Agency of the Republic of Kazakhstan

Note: *Recalculation of absolute export/import indicators carried out using average annual dollar-national currency rates. Includes operations between the countries of the Customs Union
**Data for 2010

In both Russia and Kazakhstan the volume of mechanical engineering exports as a percentage of total exports is very small and never in excess of 5%. In the Republic of Belarus, mechanical engineering exports amounted to 16.9% of total exports in 2001. On the other hand, imports of mechanical engineering production as a proportion of all imports is high in all the countries under

review: the lowest percentage is recorded by Belarus (18.8%) while Russia, with mechanical engineering products being the main type of goods imported, records the highest percentage (49.9%).

The fact that imports of mechanical engineering products outweigh exports has a significant effect on the economic growth of the SES countries. In 2011, net exports of machinery, equipment and transport facilities in Russia amounted to 7.3% of GDP. The figures for Kazakhstan are comparable to those of Russia. Only Belarus has relatively low negative net exports of mechanical engineering products at 3.7% of GDP. Belarus' total exports of mechanical engineering products are also high – 13.9% of GDP.

In 2011, **Russia's** net exports of mechanical engineering production amounted to \$135.8 billion. In other words, Russia's imports of machinery and equipment far outstrip the country's exports. Russia was, in fact, a net importer (at various levels of disaggregation) in respect of all economic activities under consideration (see Table 13.7).

As regards the export of Russian mechanical engineering products, 21.1% of the \$16.6 billion earned is accounted for by equipment, 31.3% by electrical equipment and 47.6% by transport facilities. The main exports are aircraft – \$3.1 billion; electronic components, radio apparatus, television and telecommunication equipment – \$2 billion; and electrical equipment – \$1.7 billion.

Of the \$152.4 billion of mechanical engineering imported to Russia, equipment production and transport facility production each accounted for 35.2%, while electrical equipment accounted for 31.3%. The major imports are cars – \$18.7 billion; electronic components, radio apparatus, television and telecommunications equipment – \$18.2 billion; electrical equipment – \$11 billion; equipment for the construction and resource extraction industries – \$6.3 billion; aircraft – \$5.8 billion; and agricultural equipment – \$5.6 billion.

The Russian Federation has significant opportunity to replace imports with domestic production (a process known as import substitution industrialisation). The very high demand for mechanical engineering production is currently being met mainly by imports. Moreover, in recent years Russian companies have been purchasing imported equipment more and more frequently. In 2011, they purchased imported equipment more frequently than domestic machinery and equipment.

In the short to medium term, the increase in internal demand for cars and consumer durables is likely to continue, since the market penetration of these types of products is still very low in Russia compared with more developed countries. In practically all industrial sectors, achieving maximum utilisation of current capacity in the middle of the first decade of the 2000s actually increased

the demand for machine tools – another potential growth area for mechanical engineering in Russia.

However, in many areas of the economy, the increasing demand for mechanical engineering products is being met almost entirely by foreign supplies. The available import substitution potential therefore depends on how quickly mechanical engineering equipment can be modernised. In some sectors – car manufacture, for example – it is clear that production could be modernised within a relatively short period of time, provided that consumer demand remains stable and returns on investment can be kept relatively low. Financial resources accumulated during periods of economic growth remain the major source of mechanical engineering capital investment. The latter requires special efforts on behalf of the state to facilitate companies' access to affordable sources of finance.

The potential to increase exports of Russian mechanical engineering output is, however, limited. Firstly, growing internal demand (both consumer and investment) will swallow up a large part of any increase in the volume of output and severely limit any significant accumulation of export production. Secondly, the technology gap which exists in respect of developed countries makes it difficult to forecast any significant increase in demand for Russian mechanical engineering production on world markets. At present, for almost all product groups, imports considerably outweigh exports. This indicates a weak demand for Russian products on the global market, and the situation is hardly likely to change quickly, even if there are improvements in product quality.

In 2011, **Belarus'** net exports amounted to \$1.8 billion and the value of imports was comparable to that of exports. Belarus is a net importer of equipment and electrical equipment. Import and export figures are largely comparable (although in most product groups, the volume of imports outweighed that of exports). Exports of agricultural machinery and equipment exceeded imports fourfold.

The country is only a net exporter in the transport facilities sector, where exports exceed imports mainly due to the net export of trucks. However, imports of internal combustion engines, cars and railway rolling stock all exceed the corresponding volumes of export.

With regard to mechanical engineering exports, 47.1% of the \$6.8 billion earned was accounted for by equipment, 17.6% by electrical equipment and 35.3% by transport facilities. The largest export groups are machinery and equipment for agriculture at \$1.8 billion, trucks at \$1.4 billion and electrical equipment at \$0.6 billion.

In 2011, Belarus' main imports were electrical equipment (\$1 billion); electronic components, radio apparatus, television and telecommunications equipment – (\$0.8 billion); cars – \$0.6 billion, car engines and agricultural machinery and equipment – (\$0.5 billion each).

Belarus depends on imports for a very wide range of mechanical engineering goods. In 2011, the negative trade balance in respect of such goods effectively reduced the potential GDP of the country by 17.6% – the highest figure for any of the three SES countries. The current structure of industry, recent financial difficulties and ambiguous analyses of economic growth all hamper the rapid modernisation of the mechanical engineering industry, without which import substitution industrialisation is very difficult to achieve.

At the same time, Belarus' mechanical engineering is largely export-oriented. This applies mainly to its major industries – agriculture and transportation engineering. However, these exports are primarily oriented towards supplying the SES countries – Russia and Kazakhstan, which account for some 73% of Belarussian mechanical engineering exports. In other words, increases in mechanical engineering exports in Belarus are driven by an increase in demand for Belarusian products in Russia and Kazakhstan. Further increases in demand are likely, due to integration of the three countries and forecasts of economic growth for them. Therefore, Belarus does have the potential to increase mechanical engineering exports, but its potential is primarily associated with products which are already being exported to Russia and Kazakhstan.

In 2011, the balance of trade in mechanical engineering products in **Kazakhstan** amounted to \$13.2 billion. Kazakhstan, like Russia, is a net importer in all the economic categories under consideration. Mechanical engineering exports amounted to \$0.7 billion, of which the export of equipment accounted for \$0.35 billion, electrical equipment – \$0.29 billion and transport facilities – \$0.06 billion.

In 2011, Kazakhstan's main imports included electronic components, radio apparatus, television and telecommunications equipment – \$1.8 billion; and electrical machinery and equipment and railway rolling stock – \$1.5 billion each.

According to forecasts, Kazakhstan's economy is set to undergo dynamic development, making it likely that demand for mechanical engineering products will increase. At present, however, mechanical engineering output in Kazakhstan is relatively low and the sector is not yet able to satisfy demand on its internal markets. As the economy grows, therefore, large-scale import substitution industrialisation in Kazakhstan is unlikely to take place and, in any case, is simply not practical in respect of many products, since vast resources would be needed to set up new mechanical engineering industries.

The volume of mechanical engineering exports from Kazakhstan is low – in 2011, just 0.4% of GDP (the lowest rate of all the SES countries) – and exports are focused on the Russian market. It would be unwise to predict a dramatic increase, but, given the creation of the SES, it is possible to foresee an increase

Table 13.7.

Mechanical engineering exports and imports (by type) in Russia, Belarus and Kazakhstan in 2011 (\$ billion)*

	Russia			Belarus			Kazakhstan		
	exports	imports	net exports	exports	imports	net exports	exports	imports	net exports
Mechanical engineering – total	16.6	152.4	-135.8	6.8	8.6	-1.8	0.7	13.9	-13.2
Equipment production	3.5	53.6	-50.2	3.2	3.9	-0.7	0.4	5.5	-5.2
Production of turbines and engines, excluding aircraft, rocket, motor vehicle and motor cycle engines	0.2	0.6	-0.4	0	0	0	0	0.1	-0.1
Production of bearings, toothed gears and parts for mechanical transmissions and drives	0.3	1.1	-0.8	0.1	0.3	-0.2	0.1	0.2	-0.1
Production of agricultural machinery and equipment	0.2	5.6	-5.5	1.8	0.5	1.3	0	0.4	-0.4
Machine tool production	0.1	2.5	-2.4	0.1	0.3	-0.2	0	0.1	-0.1
Production of lift equipment	0.1	3	-2.9	0.2	0.3	-0.1	0	0.2	-0.2
Production of machinery and equipment for the metallurgical industry	0.1	1.1	-1	0	0.1	0	0	0.1	-0.1
Production of machinery and equipment for the construction and resource extraction industries	0.5	6.3	-5.8	0.2	0.4	-0.2	0	0.9	-0.8
Production of domestic appliances not included in other groups (refrigerators, freezers, washing machines, dishwashers, microwave ovens, etc.)	0.1	1.9	-1.8	0	0.1	0	0	0.1	-0.1
Production of electrical, electronic and optical equipment	5.2	45.1	-40	1.2	2.6	-1.4	0.3	5	-4.7
Production of office equipment	0.1	2.7	-2.6	0	0.1	-0.1	0	0.2	-0.2
Production of electronic calculators and other information processing equipment	0.2	5.3	-5.1	0	0.2	-0.1	0.1	0.6	-0.5
Production of electrical machinery and equipment	1.7	11	-9.3	0.6	1	-0.3	0.1	1.5	-1.4
Production of medical equipment, including surgical equipment and orthopaedic appliances	0.1	4.1	-4	0.1	0.2	-0.2	0	0.5	-0.5

	Russia			Belarus			Kazakhstan		
	exports	imports	net exports	exports	imports	net exports	exports	imports	net exports
Production of electronic components, radio apparatus, television and telecommunications equipment	2	18.2	-16.2	0.2	0.8	-0.6	0.1	1.8	-1.7
Production of measuring, monitoring, test and control equipment; optical devices, photographic and cinematographic equipments; clocks and watches	1.2	3.9	-2.8	0.2	0.3	-0.1	0	0.5	-0.4
Production of transport facilities	7.9	53.6	-45.7	2.4	2.1	0.3	0.1	3.4	-3.3
Production of internal combustion engines for motor vehicles	0.5	3.1	-2.7	0.2	0.5	-0.4	0	0.2	-0.2
Motor car production	0.5	18.7	-18.2	0.1	0.6	-0.5	0	0.6	-0.6
Bus and trolleybus production	0.1	0.5	-0.4	0.1	0	0.1	0	0.1	-0.1
Truck production	0.3	3.5	-3.2	1.4	0.1	1.3	0	0.4	-0.4
Shipbuilding and ship repair	1.6	3.9	-2.2	0	0	0	NA	NA	NA
Railway rolling stock production	0.8	3.7	-2.8	0	0.4	-0.3	0	1.5	-1.5
Aircraft production, including spacecraft	3.1	5.8	-2.6	NA	NA	NA	NA	NA	NA

Source: Customs Union Commission, UN Statistics Division, IEF RAS estimates

Note: 'NA' - no data available. The import and export data for Russia and Belarus were compiled using the FEACN six-figure coding. Since Kazakhstan's foreign trade statistics are based on FEACN four-figure coding, the figures for import and export data based on economic activity are estimated

in the flow of exports in some product groups (for example, bearings and electrical equipment).

The volume of trade in mechanical engineering products among the SES countries is very small when compared to the total volume of external trade. In 2011, the total combined export and import of mechanical engineering products in the region amounted to approximately \$200 billion, yet trade between the countries only amounted to approximately \$20 billion or 10% of the total volume.

In 2011, the flow of mechanical engineering exports among the SES countries accounted for \$10.5 billion.

At the same time, several large-scale mechanical engineering production flows can be identified in trading between SES countries (see the top section of Table 13.8):

- Exports from Belarus to Russia – \$4.7 billion in 2011;
- Exports from Russia to Kazakhstan – \$3.3 billion;
- Exports from Russia to Belarus – \$1.9 billion.

The flows of exports from Kazakhstan to Russia and from Belarus to Kazakhstan are much smaller, amounting to \$0.4 and \$0.2 billion respectively.

The dependence of exporters of machine-building products on individual SES country markets varies considerably (see the middle section of Table 13.8). These market shares are critically important to producers of machinery and equipment in Belarus and Kazakhstan. Belarus directs 72% of all exports into the SES – 69.1% of which go to Russia. The SES absorbs 55.7% of Kazakh exports, nearly all of which go to Russia. At the same time, Russia is less

Table 13.8.
Flow of mechanical
engineering
production between
the SES countries
and the rest of the
world in 2011

Source: Customs
Union Commission,
UN Statistics
Division, IEF RAS
estimates

			In				
			Russia	Belarus	Kazakhstan	Rest of the world	Total
Export (\$ billion)	From	Russia	1.9	3.3	11.4	16.6	
		Belarus	4.7	0.2	1.9	6.8	
		Kazakhstan	0.4	0	0.3	0.7	
		Rest of the world	147.3	6.7	10.4	164.4	
		Total	152.4	8.6	13.9	13.6	188.5
			In				
		Russia	Belarus	Kazakhstan	Rest of the world	Total	
Export (%)	From	Russia	11.4	19.9	68.7	100	
		Belarus	69.1	3.2	27.7	100	
		Kazakhstan	55	0.7	44.3	100	
		Rest of the world	89.6	4.1	6.3	100	
		Total	79.9	4.5	7.3	8.3	100
			From				
		Russia	Belarus	Kazakhstan	Rest of the world	Total	
Import (%)	In	Russia	3.1	0.3	96.6	100	
		Belarus	22.1	0.1	77.8	100	
		Kazakhstan	23.8	1.6	74.6	100	
		Rest of the world	83.8	14.0	2.2	100	
		Total	8.7	3.6	0.4	87.3	100

dependent on the SES countries' markets – only 31.3% of all Russian mechanical engineering exports end up in the region (19.9% in Kazakhstan and 11.4% in Belarus).

Russia imports virtually no mechanical engineering goods from the SES region. Countries outside the SES region accounted for 96.6% of all imports to Russia in 2011 (see the bottom section of Table 13.8). In Belarus and Kazakhstan the corresponding figures are 77.8% and 74.6% respectively – the remaining imports to these countries come from Russia. It is clear that Russia's imports of mechanical engineering products come overwhelmingly from countries outside the SES region. This is direct evidence of the low levels of competitiveness plaguing the SES's mechanical engineering companies.

The major directions of flow of mechanical engineering products between the SES countries have remained stable over the last four years (see Figure 13.1). However, flow volumes have fluctuated markedly. These fluctuations can be explained by the fall in demand for equipment and transport facilities brought about by the global economic crisis. In 2009, a sharp decline in foreign trade was observed as a result of the crisis. In 2011, the major flows not only recovered, but went on to exceed their pre-crisis levels.

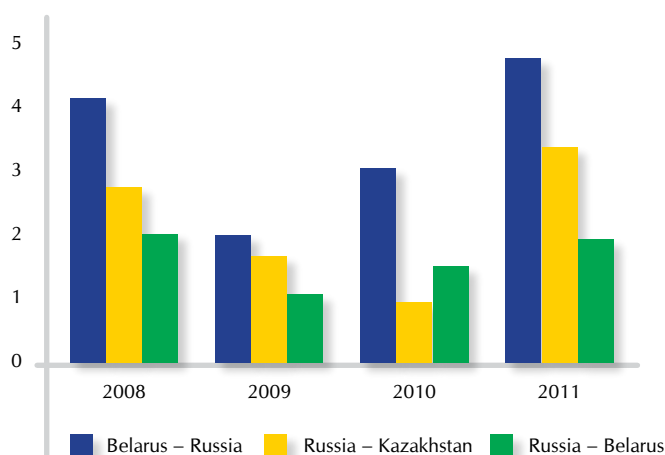


Figure 13.1.
Major flows
of mechanical
engineering
production between
the SES countries in
2008–2011
(\$ billion)

Note: The first
country in the pair is
the exporter

Table 13.9 gives a breakdown (by type of economic activity) of the three largest export flows of mechanical engineering products between the countries. Exports to Russia from Belarus mainly involve agricultural machinery and equipment (\$1.14 billion in 2011), trucks (\$1.01 billion) and electrical equipment (\$0.49 billion). There are also significant flows of machinery and equipment for the construction and mining sectors; pumps, compressors and hydraulic systems and vehicle engines.

Table 13.9.

Major mechanical engineering export flows between the SES countries in 2011*

	Exports, Belarus to Russia			Exports, Russia to Belarus			Exports, Russia to Kazakhstan		
	\$ billion	% exports, Belarus to all countries	% imports, Russia from all countries	\$ billion	% exports, Russia to all countries	% imports, Belarus from all countries	\$ billion	% exports, Russia to all countries	% imports, Kazakhstan from all countries
Mechanical engineering - total	4.71	69.1	3.1	1.88	11.4	22.4	3.33	19.9	24
Equipment production (excluding the production of arms and ammunition)	2.17	67.4	4	0.55	15.9	14.2	1.18	34.1	21.4
Production of pumps, compressors and hydraulic systems	0.14	80.3	3.5	0.07	20.1	21.1	0.25	72.4	34.2
Production of bearings, toothed gears and parts for mechanical transmissions and drives	0.06	68.6	5.5	0.07	23.1	28.2	0.07	21.6	37
Production of agricultural machinery and equipment	1.14	64.4	20.4	0.02	13.2	4.1	0.11	73.6	26.2
Machine tool production	0.07	83.6	2.8	0.02	17.3	7.1	0.02	20.3	29.6
Production of lift equipment	0.12	79.5	4	0.03	29	12.8	0.05	47.9	25.1
Production of machinery and equipment for the construction and resource extraction industries	0.15	84.7	2.4	0.07	14.8	19.5	0.13	28.4	15.4
Production of domestic appliances not included in other groups (refrigerators, freezers, washing machines, dish washers, microwave ovens, etc.)	0.04	84.3	2.2	0.01	9.3	11.9	0.03	27.4	21.2
Production of electrical, electronic and optical equipment	0.83	70.3	1.8	0.64	12.5	25	1.02	19.9	20.3
Production of electrical machinery and equipment	0.49	79.1	4.5	0.35	21.5	37.2	0.52	32	34.4

	Exports, Belarus to Russia			Exports, Russia to Belarus			Exports, Russia to Kazakhstan		
	\$ billion	% exports, Belarus to all countries	% imports, Russia from all countries	\$ billion	% exports, Russia to all countries	% imports, Belarus from all countries	\$ billion	% exports, Russia to all countries	% imports, Kazakhstan from all countries
Production of electronic components, radio apparatus, television and telecommunications equipment	0.18	76.6	1	0.18	8.9	20.8	0.3	14.6	16.6
Production of measuring, monitoring, test and control equipment; optical devices, photographic and cinematographic equipments; clocks and watches	0.13	58.7	3.3	0.08	7.2	30.4	0.12	10.7	25.9
Production of transport facilities and associated equipment	1.71	71.1	3.2	0.68	8.7	32.2	1.13	14.5	33.6
Production of internal combustion engines for motor vehicles	0.13	73.8	4	0.27	59.4	48.8	0.04	9.9	24
Car production	0.09	99.6	0.5	0.03	6.6	6	0.13	27.9	20.2
Bus and trolleybus production	0.08	51.8	15.7	0.01	9.6	45.9	0.04	37.1	32.7
Truck production	1.01	74.1	28.8	0.03	9	27.3	0.12	37.1	30.8
Rolling stock production	0.03	62.9	0.7	0.22	26.1	59.9	0.62	73.1	41.5

Source: Customs Union Commission, UN Statistics Division, IEF RAS estimates

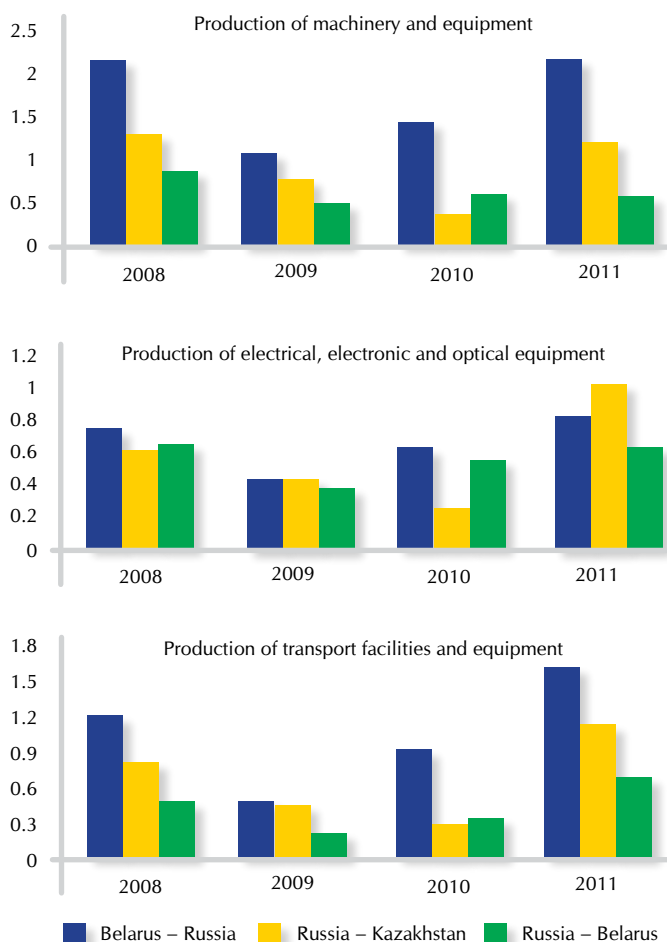
Note: The economic activity import and export data for Russia and Belarus was compiled using the FEACN six-figure coding. Since Kazakhstan's foreign trade statistics are based on FEACN four-figure coding, the figures for import and export data based on economic activity are estimated

At least one half of all Belarus' major exports are to Russia. However, the majority of Belarus' exports rarely enjoy a share on Russia's markets in excess of 5% (the exceptions are trucks – 28.8%, machinery and equipment for agriculture – 20.4% and buses and trolleybuses – 15.7%).

The major Russian exports to Belarus are electrical equipment (\$0.35 billion in 2011), vehicle engines (\$0.27 billion), rolling stock (\$0.22 billion) and electronic components, radio apparatus, television and telecommunications equipment (\$0.18 billion). Some Russian exports enjoy a significant share of Belarus' market. Exports of vehicle engines, for example, have a 59.4% market share in Belarus. Railway rolling stock occupies 26.1% of the market, while electrical machinery and equipment exports have a 21.5% share. In fact, Russian

Figure 13.2.
Major flows
of mechanical
engineering products
between the SES
countries in 2008-
2011 (by type of
economic activity,
\$ billion)

Note: The first
country of the pair
is the exporter



goods in general enjoy high market share in Belarus, sometimes reaching 50–60%.

The dominant exports from Russia to Kazakhstan are rolling stock (\$0.62 billion in 2011), electrical equipment (\$0.52 billion) and electronic components, radio apparatus, television and telecommunications equipment (\$0.3 billion).

The dynamics of the major export flows of mechanical engineering subsectors in 2008–2011 were similar to those observed for mechanical engineering production as a whole (see Figure 13.2), i.e. a reduction in the volumes exported was observed during 2009 due to the crisis, returning to (or exceeding) pre-crisis volumes in 2011. Note that the export of electrical, electronic and optical equipment from Russia to Kazakhstan in 2011 was several times higher than the 2010 figure and exceeded the corresponding export figure from Belarus to Russia.

CURRENT INTEGRATION PROCESSES IN MECHANICAL ENGINEERING

One of the most important and realistic ways of developing the mechanical engineering sector in the current economic climate would be to encourage cooperation between the SES countries. This would help increase production, boost exports, expand investment and promote the introduction of new technologies.

The creation of the Customs Union (CU) and SES, and the prospect of other countries being allowed to join, is leading to a reduction in the cost of trade between the member countries and opening up new possibilities for cooperation, both for companies in the mechanical engineering sector and for their suppliers. In addition, single customs tariffs create barriers to the supply of mechanical engineering products from outside the region and increase demand for products made inside in the SES region, speeding up the process of import substitution industrialisation.

The Eurasian Economic Commission is actively involved in forming the statutory and regulatory basis of the CU and the SES. The process of introducing CU standards and practices in its member states began in 2012. These are needed to ensure that the SES functions under a common set of safety regulations and mutual recognition by its members of the competent certifying bodies. Once these standards and practices have been adopted, the corresponding national regulations will cease to apply.

The mechanical engineering activities subject to common CU regulations include: machinery and equipment, high- and low-voltage equipment, wheeled vehicles, tractors, agricultural machinery, forestry machinery, railway and rapid-transit rolling stock, light-rail vehicles, trams, watercraft, systems and equipment for metering water, gas, thermal energy and electrical energy, systems and equipment for the processing and measurement of crude oil

and telecommunications systems. Many of the CU standards and practices will come into force over the next two to three years and will help increase competitiveness, stimulate innovation and protect markets from infiltration by inferior quality products.

The strengthening of integration processes will allow the region's historical mechanical engineering production links to be restored and further developed.

The cooperation process is already underway. For example, the global leader in the production of dumper trucks, BelAZ (OJSC Belarusian Autoworks), is developing actively. The company has a strong position on the Russian and Kazakh markets, where it owns assembly plants and production facilities. In addition, the merger of the leaders of the Russian and Belarusian truck industries, KamAZ and MAZ, is a possibility.

In Kazakhstan, the production of vehicles and their supply to the single market have been developed by joint enterprises between Kazakh and Russian companies. For example, since 2003, JSC Asia Auto has been manufacturing VAZ automobiles in Ust-Kamenogorsk. Also based in Kazakhstan, JSC AgromashHolding manufactures engines and various types of farm machinery in conjunction with Russian companies. JSC KAMAZ-Engineering is a joint Kazakh-Russian project for the production of motor vehicles.

Late 2012 saw the launch of an electric locomotive plant, a joint venture between JSC National Company Kazakhstan Temir Zholy, the French corporation Alstom Holdings and the Russian ZAO Transmashholding. Alstom and Transmashholding will supply components for production. It is expected that up to 40% of the plant's output will be exported to CIS countries.

It can thus be seen that the establishment of the SES is bringing new opportunities for further development of the sector, as well lifting restrictions on the transfer of labour, capital and goods. The SES countries have huge potential to develop mechanical engineering thanks to the presence of one of the most promising domestic markets in the world, and the availability of the resources required for this development. These combine to provide opportunities for increasing both efficiency and export volumes, with the end result of greater economic development for all the member countries.

CIS Region Countries: A Slowdown in 2012 and the Prospects for Moderate Acceleration in the Medium Term

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At the end of the last year developing countries remained the main driving force of global economic growth: 5.1% on average, compared with 1.2% shown by wealthier economies. On the whole, world economy indicators improved in the fourth quarter of the year when the central banks of leading countries eased their monetary and credit policies. Despite the universal implementation of quantitative easing measures, there was no significant increase in inflationary pressure; however, neither was an equal growth in credit activity seen. Oil (Brent Crude) prices averaged \$112 per barrel in 2012 with a 1% increase over 2011. By comparison, in the previous year these prices increased by 39%.

Figure 14.1.
Economic growth
and oil prices
(% of the previous
year's figure)

Source: WB,
consensus forecast
of EDB, national
ministries

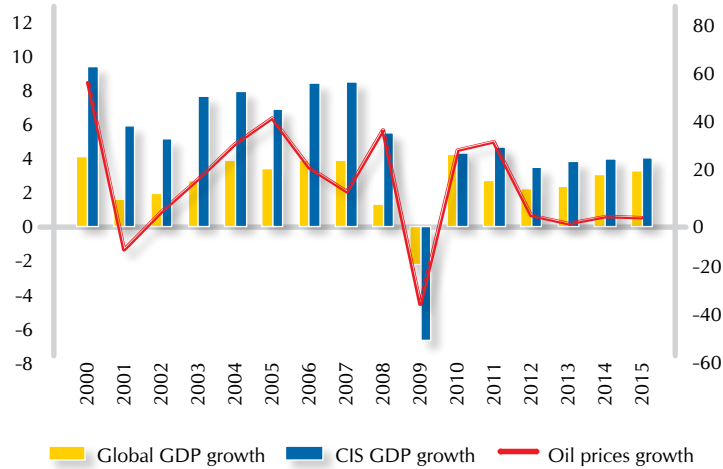
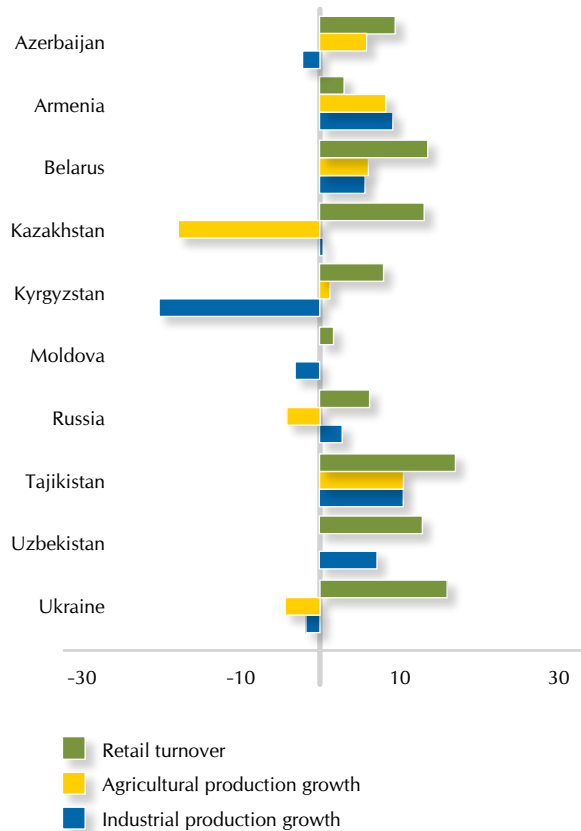


Figure 14.2.
Economic growth
in the CIS (2012,
% of the previous
year's figure)

Source: national
ministries



Aggregate CIS countries' GDP grew by 3.4% in real terms in 2012, compared with 4.7% in 2011. This reflects the effects of a slowdown in the global economy, oil prices in oil and gas exporting countries, and remittances by migrant workers in oil importing countries. Also there was a direct influence of the economic situation in Europe on some economies which have close ties with European countries (Russia, Kazakhstan, Belarus and Ukraine). Thus, the overall feature of the region's economic development at the end of 2012 was a slippage in investment demand and production in export-oriented industries. Production in the agriculture sector also showed a trough against the backdrop of the previous year's bumper harvest and the drought that hit the cereal exporting countries in 2012. Consumer demand and the industries that serve it, such as trade and commercial services, remained the driving force of growth virtually throughout the CIS. The financial sector demonstrated a satisfactory increase in lending at the beginning of the year which slowed down in the second half of the year following the overall decline in economic activity.

The slowdown or, in some countries, decline in production growth rates in export-oriented industries coupled with strong domestic demand impacted CIS countries' foreign trade performance: in oil and gas producing economies, foreign trade surplus declined, whereas in labour exporting countries, despite their lower export figures and higher import figures, the continuing inflow of migrant workers' remittances eventually served to improve their current trade balance.

The financial account of CIS countries' BoP showed a decline over the last year, reflecting a decline in inflow in the upper entries of oil exporters' BoP. A significant increase in direct investments (6.2% of GDP) was recorded in Kazakhstan, whereas in the rest of the region direct investments remained at low levels. There was an outflow of capital surplus from oil exporting economies which was recorded in BoP as portfolio investments (in Kazakhstan) or other investments (in Russia). In all countries except Belarus and Ukraine there was an inflow of debt capital, and a consequential increase in foreign debt. The aggregate foreign debt of the CIS grew by 13% over the last year. Private sector borrowings played a major role in the foreign debt growth in Belarus, Kazakhstan, Russia, Kyrgyzstan, Moldova and Ukraine. Private and public sector foreign debt in the region increased by 13% and 15%, respectively. A significant nominal increase in public debt was observed in Russia: from 2.5% to 3.2% of GDP.

The balance of payments dynamics in the region in the last year led to a net increase in the reserve assets of central banks totalling \$28.8 billion, which is about 1.1% of the region's overall GDP. The reserves grew in terms of GDP significantly in Azerbaijan (7.2% of GDP) and Moldova (6.9% of GDP). By contrast, the reserves shrank in Armenia, Kazakhstan and Ukraine. Another result of the these dynamics in the last year was an appreciation of

Figure 14.3.
Current account
of BoP: (% of GDP)

Source: national
ministries

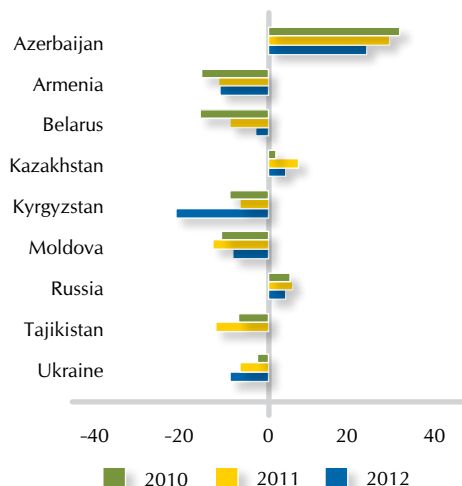
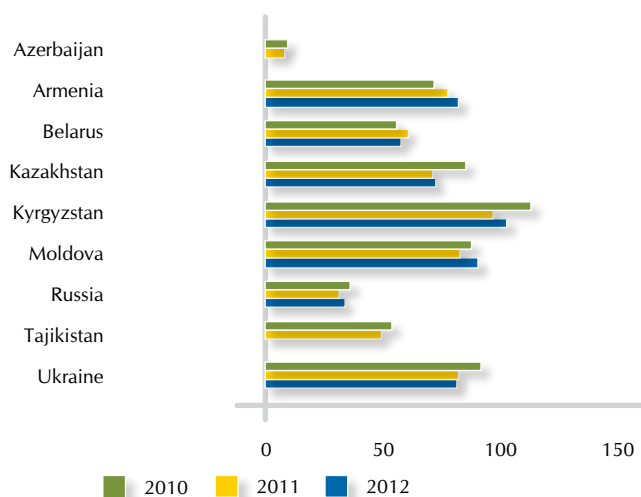


Figure 14.4.
Foreign debt: gross
(% of GDP)

Source: national
ministries



the real effective exchange rate (REER) in Azerbaijan, Kazakhstan, Moldova, Russia and Ukraine, and the depreciation of REER of Armenia, Belarus and Kyrgyzstan.

A dip in economic activity resulted in a shrinkage in tax revenue in most countries, whereas public expenditure was up from the last year throughout the region due to an increase in government workers' salaries, welfare payments and public investments. In nearly all countries of the region the commitment to increase current expenditures contributed to the deterioration of government

budget balances. However, in some economies with persisting budgetary deficit such as Moldova, Tajikistan and Armenia there were improvements in effectiveness in public revenue collection and moderate consolidation of expenditure.

Against the backdrop of a slowdown in the real sector and the high previous year’s benchmark, growth of food prices on the consumer market was rather slow during the first half of the year. Low inflation rates encouraged the central banks of Belarus, Kazakhstan, Kyrgyzstan and Tajikistan to proceed with the easing of their monetary and credit policies from the first quarter of this year. By contrast, the Bank of Russia kept its interest rate unchanged during the first eight months of the year and then raised it in September 2012, facing accelerated inflation after the scheduled increase in regulated tariffs. Annual growth in prices in Belarus totalled 21.8% in December 2012, which is a dramatic improvement versus 108.7% in the previous year. However, following the sharp reduction of the refinancing rate by the National Bank of Belarus from 45% to 32% in the first half of the year, monetary expansion accelerated considerably. On the whole, annual inflation in the region in December 2012 was 6.2%, as compared with 9.2% in December of the previous year.

As inflation risks decreased in the beginning of the last year, there was an increase in bank lending activity in some CIS countries. However, the slowdown of the second half of the year affected this segment as well. Annual increase in lending was 10-22% in all these economies except Armenia, Belarus and Tajikistan,

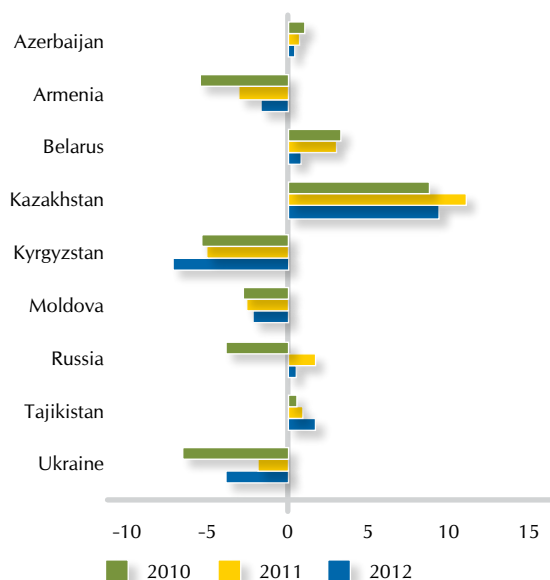
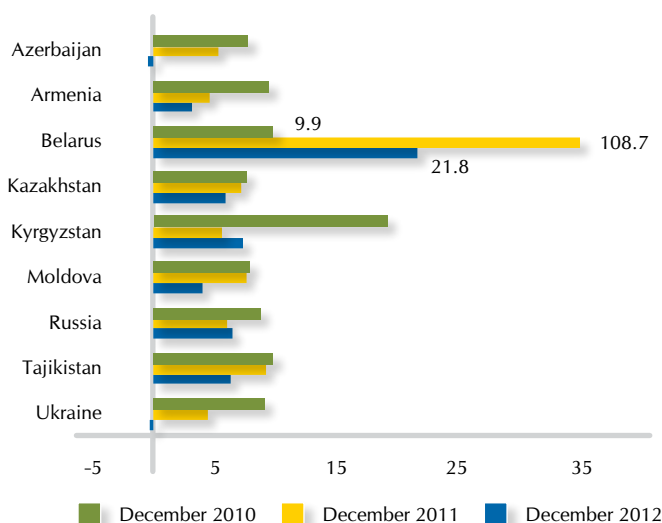


Figure 14.5.
 State budget:
 balance, accrued
 total (% of GDP)

Source: national
 ministries

Figure 14.6.
Monetary policy:
CPI growth (% of
the same period of
the previous year)

Source: national
ministries



where in September of the last year this indicator was 32%, 49% and 30%, respectively. Notably, there is particular concern about growth in lending in foreign currency and the overall growth in the distressed loan portfolios of CIS banks.

According to the World Economic Outlook released by the IMF in April 2013, rehabilitation of the world economy is an unstable and uncertain process, and the global economic growth is likely to slow down somewhat in the current year, before continuing at higher rates in 2014. Developing economies will remain the driving force of the process, growing at 5.7% per annum in 2014. The growth rates of developed economies will increase from 1.2% to 2.2% in the next few years.

As the world economy shows signs of recovery, the EDB's basic medium-term development scenario also envisages the gradual resolution of the debt crisis in the Eurozone, which will enable many European economies to demonstrate positive dynamics by 2014. The US economy will gradually reach a growth rate of 3%. Positive developments in Europe and the US and domestic stimulating policies will all work to sustain economic growth in China. Notably, all leading economies will stick to soft monetary and credit policy in the near future (2013). As a result, prices of raw commodities exported by EDB member states will remain relatively high and volatile, averaging out at about \$109 per barrel, i.e. last year's levels.

In the CIS, economic activity is concentrated principally in oil exporting countries. Therefore, the most probable scenario is that moderate positive

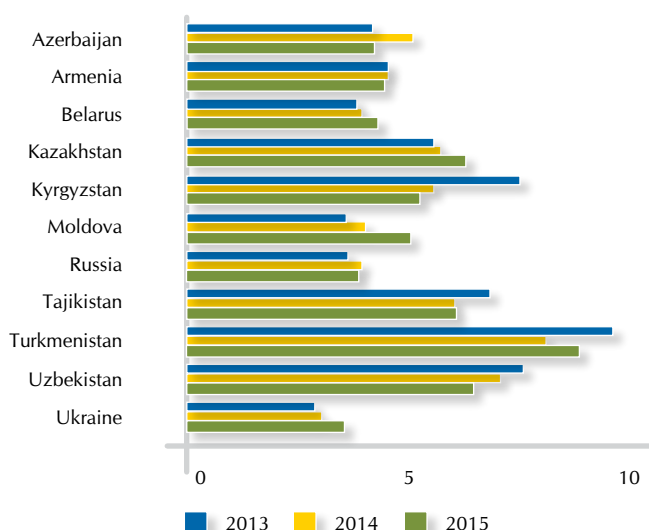


Figure 14.7.
 Forecast of growth of CIS economies:
 GDP consensus
 forecast (% of the
 previous year's
 figure)

Source: forecasts and assessments of national ministries, EDB, IMF, WB and ADB

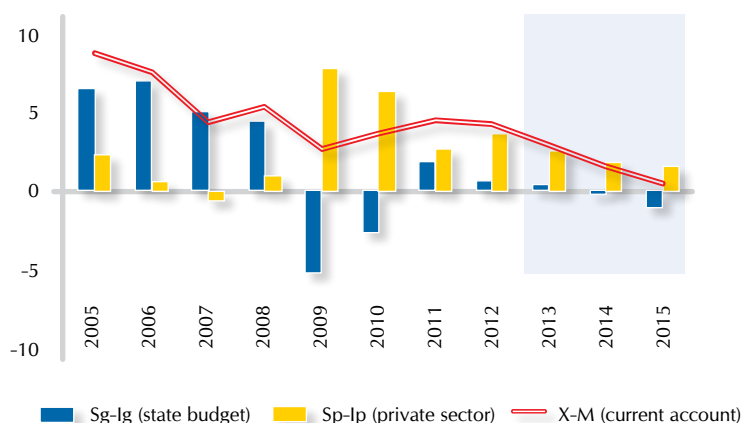


Figure 14.8.
 Savings and
 investments
 (% of GDP): private
 investments and
 savings (Sp-Ip),
 state budget (Sg-Ig),
 current account
 (X-M)

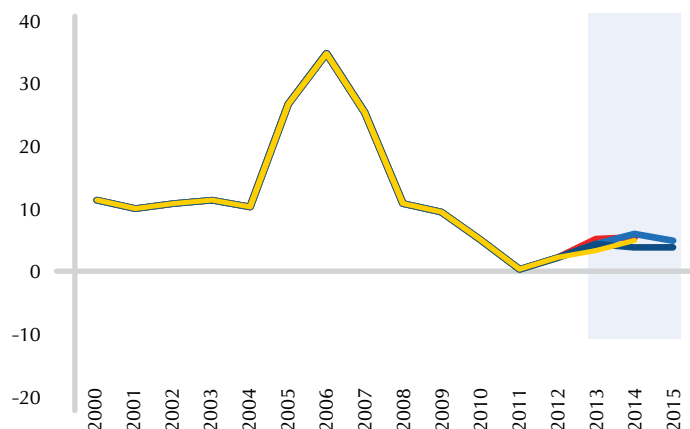
Source: IMF

growth rates will be preserved in the region. The consensus forecast of various ministries is 3.8% for the current year and 4-4.5% for 2014-2015. If we divide the region into groups, growth in oil exporting countries will average about 4%, driven by domestic demand. Growth in labour exporting countries will be 5-5.5%. The latter are increasingly dependent on remittances, and retain a large deficit on their current account of BoP. The most rapid acceleration of economic growth is expected to occur in Ukraine, Moldova and Belarus (from 3.6% in the current year to 5.2% in 2015), as these economies suffered the worst slowdown in 2012.

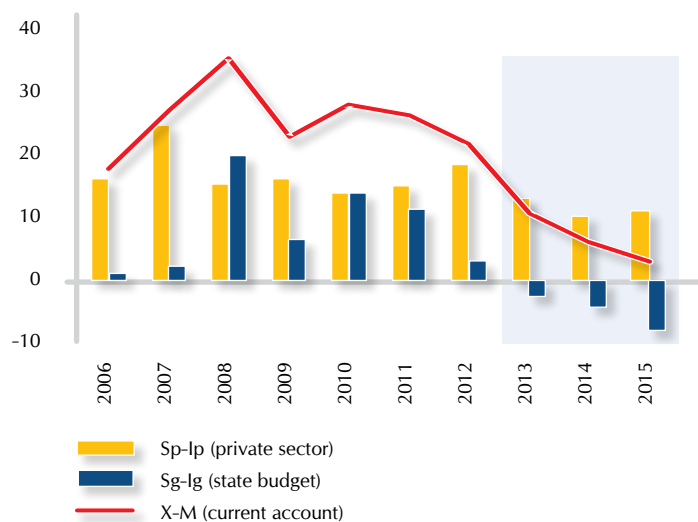
ECONOMIC SITUATION: AZERBAIJAN

Economic growth:
GDP growth and
forecasts of national
and international
institutions (%)

Source: facts and
forecasts of national
ministries, ADB, WB,
EBRD and IMF



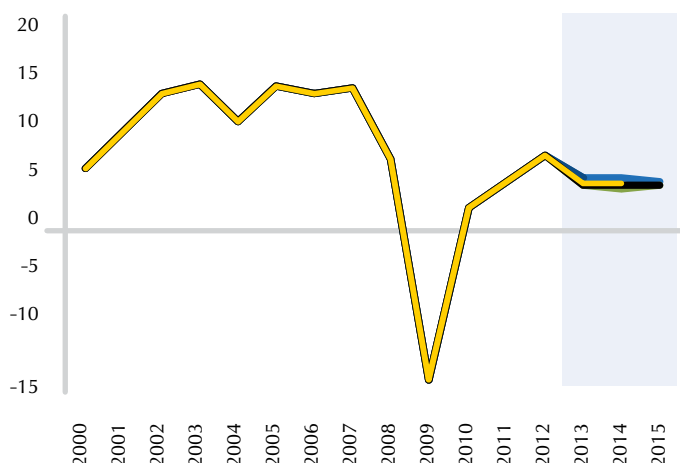
Savings and investments
(% of GDP): balance
of private savings and
investments (Sp-Ip),
state budget (Sg-Ig),
current account
(X-M)



Key indicators
(statistics and
assessments of
national ministries
and IMF)

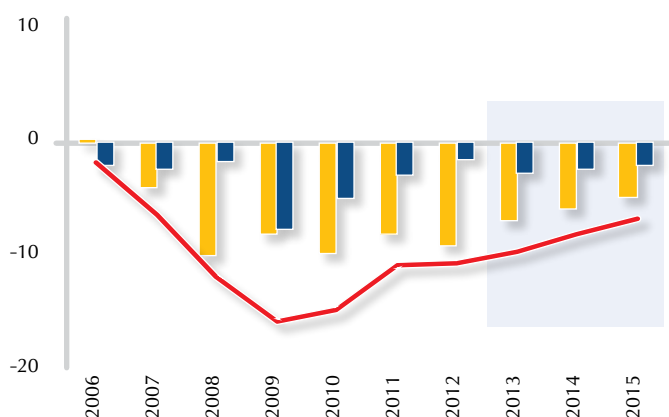
	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	10.8	9.3	5	0.1	2.2
Per capita GDP (\$)	5282	4978	5881	7114	7450
CPI growth (% of the previous year's figure)	20.8	1.8	7.8	5.5	-0.3
Government budget (% of GDP)	20	6.6	14	11.3	3.1
Current account balance (% of GDP)	35.5	23	28	26.5	20.3

ECONOMIC SITUATION: ARMENIA



Economic growth:
 GDP growth and
 forecasts of national
 and international
 institutions (%)

Source: facts and
 forecasts of national
 ministries, EDB,
 ADB, WB, EBRD
 and IMF



**Savings
 and investments**
 (% of GDP): balance
 of private savings and
 investments (Sp-Ip),
 state budget (Sg-Ig),
 current account
 (X-M)

■ Sp-Ip (private sector)
 ■ Sg-Ig (state budget)
 — X-M (current account)

	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	6.9	-14.2	2.2	4.7	7.2
Per capita GDP (\$)	3606	2647	2807	3043	2991
CPI growth (% of the previous year's figure)	5.2	6.5	9.3	4.7	3.1
Government budget (% of GDP)	-1.8	-7.7	-5	-2.9	-1.5
Current account balance (% of GDP)	-11.8	-15.8	-14.8	-10.9	-10.6

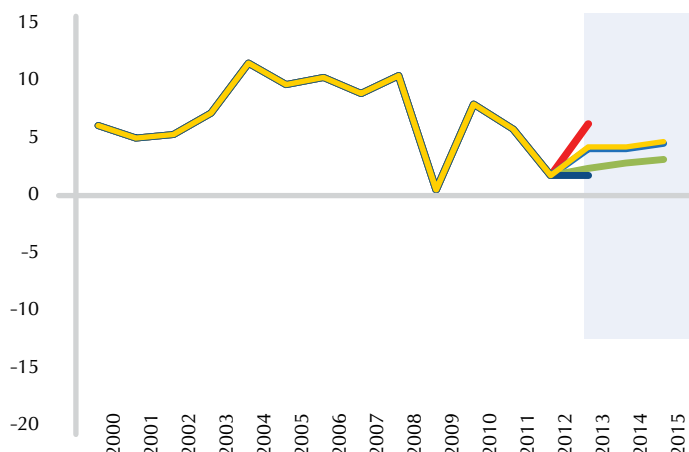
Key indicators
 (statistics and
 assessments of
 national ministries
 and IMF)

ECONOMIC SITUATION: BELARUS

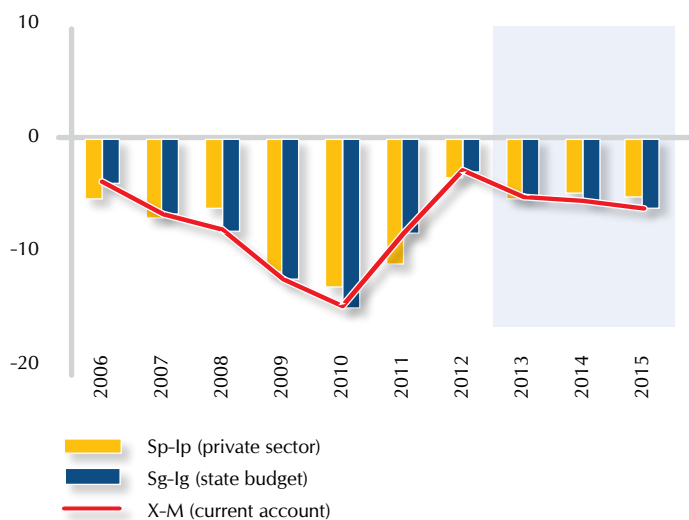
Economic growth:

GDP growth and forecasts of national and international institutions (%)

Source: facts and forecasts of national ministries, EDB, WB, EBRD and IMF



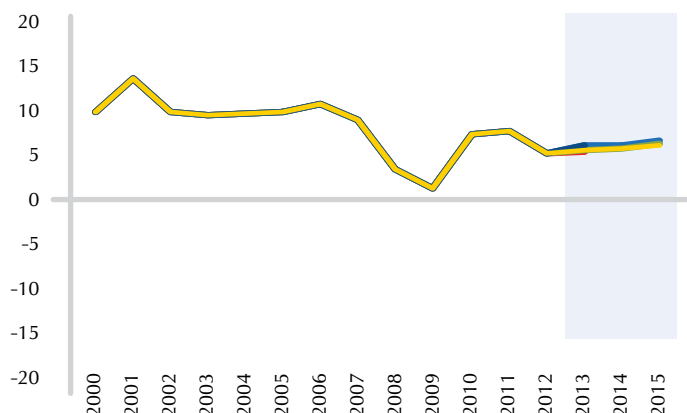
Savings and investments
(% of GDP): balance of private savings and investments (Sp-Ip), state budget (Sg-Ig), current account (X-M)



	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	10.2	0.2	7.7	5.5	1.5
Per capita GDP (\$)	6386	5180	5824	6332	6739
CPI growth (% of the previous year's figure)	13.3	10.1	9.9	108.7	21.8
Government budget (% of GDP)	-2	-0.7	-1.8	2.8	0.7
Current account balance (% of GDP)	-8.2	-12.6	-15	-9.7	-2.9

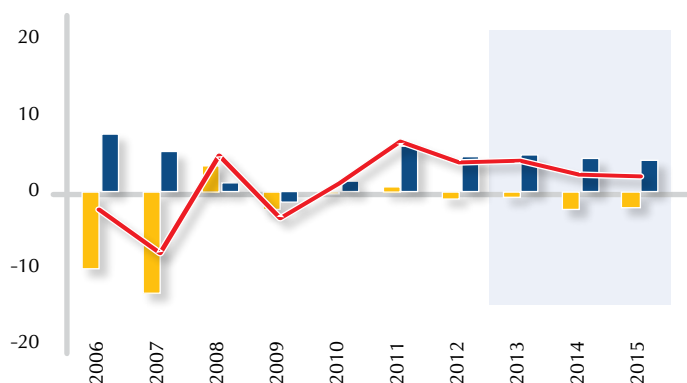
Key indicators
(statistics and assessments of national ministries and IMF)

ECONOMIC SITUATION: KAZAKHSTAN



Economic growth:
 GDP growth and
 forecasts of national
 and international
 institutions (%)

Source: facts and
 forecasts of national
 ministries, EDB,
 ADB, WB, EBRD
 and IMF



**Savings
 and investments**
 (% of GDP): balance
 of private savings and
 investments (Sp-Ip),
 state budget (Sg-Ig),
 current account
 (X-M)

■ Sp-Ip (private sector)
 ■ Sg-Ig (state budget)
 — X-M (current account)

	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	3.3	1.2	7.3	7.5	5
Per capita GDP (\$)	8684	7309	9232	11195	11773
CPI growth (% of the previous year's figure)	9.5	6.2	7.8	7.4	6.1
Government budget (% of GDP)	1.2	-1.3	1.5	5.9	4.7
Current account balance (% of GDP)	4.7	-3.6	1.2	7.4	4.6

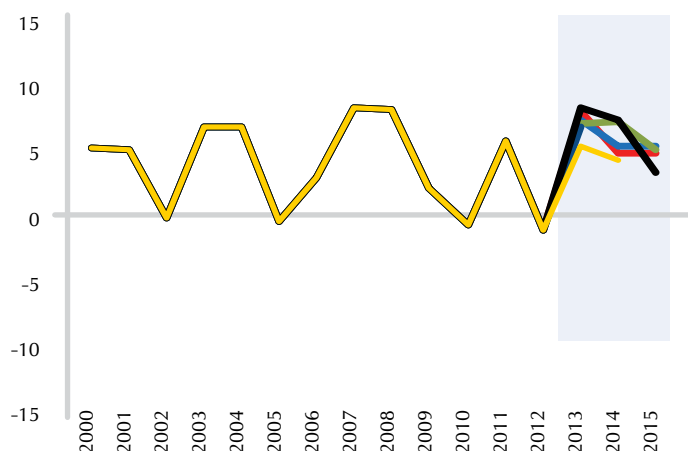
Key indicators
 (statistics and
 assessments of
 national ministries
 and IMF)

ECONOMIC SITUATION: KYRGYZSTAN

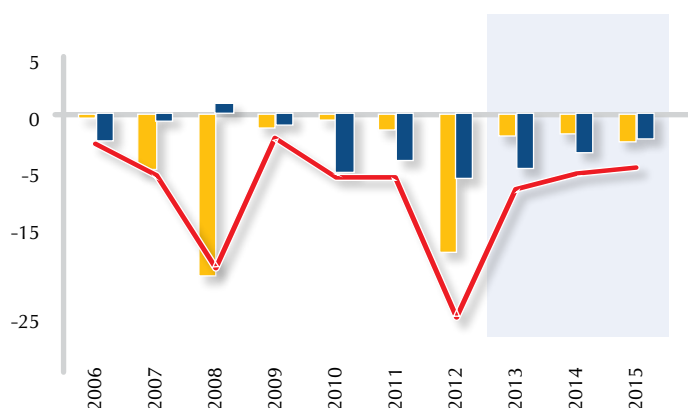
Economic growth:

GDP growth and forecasts of national and international institutions (%)

Source: facts and forecasts of national ministries, EDB, ADB, WB, EBRD and IMF



Savings and investments
(% of GDP): balance of private savings and investments (Sp-Ip), state budget (Sg-Ig), current account (X-M)

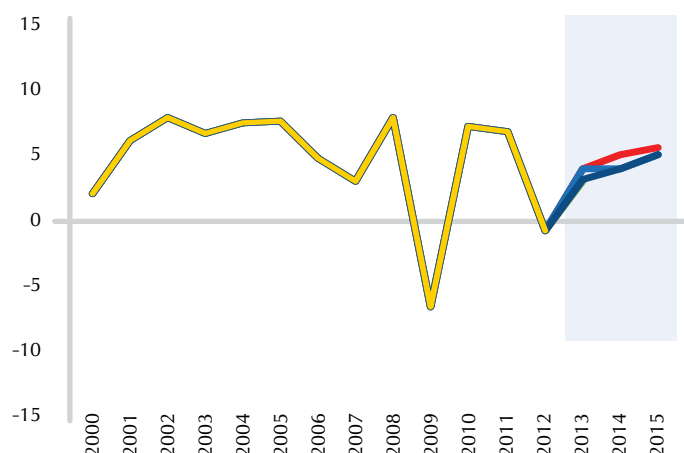


Sp-Ip (private sector)
Sg-Ig (state budget)
X-M (current account)

Key indicators
(statistics and assessments of national ministries and IMF)

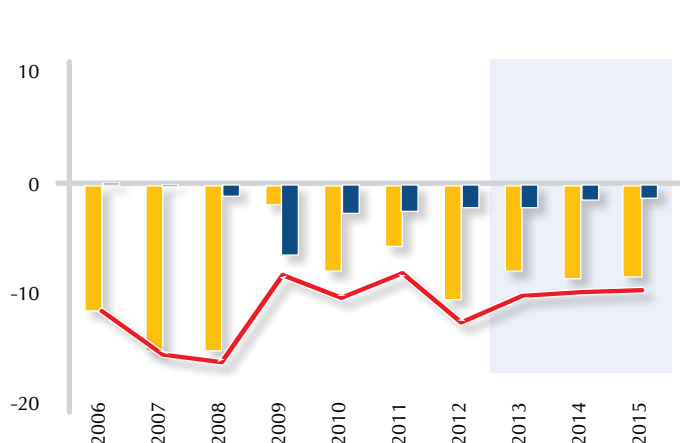
	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	8.4	2.3	-0.5	6	-0.9
Per capita GDP (\$)	959	864	875	1120	1158
CPI growth (% of the previous year's figure)	20	0	19.2	5.7	7.5
Government budget (% of GDP)	-1	-6.4	-2.5	-2.4	-2.1
Current account balance (% of GDP)	-15.5	-2.5	-6.4	-6	-12.7

ECONOMIC SITUATION: MOLDOVA



Economic growth:
 GDP growth and
 forecasts of national
 and international
 institutions (%)

Source: facts and
 forecasts of national
 ministries, WB,
 EBRD and IMF



**Savings
 and investments**
 (% of GDP): balance
 of private savings and
 investments (Sp-Ip),
 state budget (Sg-Ig),
 current account
 (X-M)

Sp-Ip (private sector)
 Sg-Ig (state budget)
 X-M (current account)

	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	7.8	-6.5	7.1	6.8	-0.8
Per capita GDP (\$)	1695	1524	1631	1971	2037
CPI growth (% of the previous year's figure)	7.2	0.5	8	7.8	4.1
Government budget (% of GDP)	-1	-6.4	-2.5	-2.4	-2.1
Current account balance (% of GDP)	-16.1	-8.2	-7.7	-11.3	-9.4

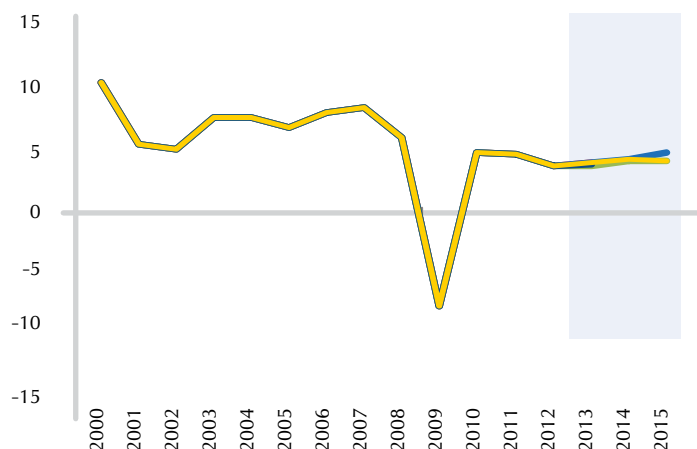
Key indicators
 (statistics and
 assessments of
 national ministries
 and IMF)

ECONOMIC SITUATION: RUSSIA

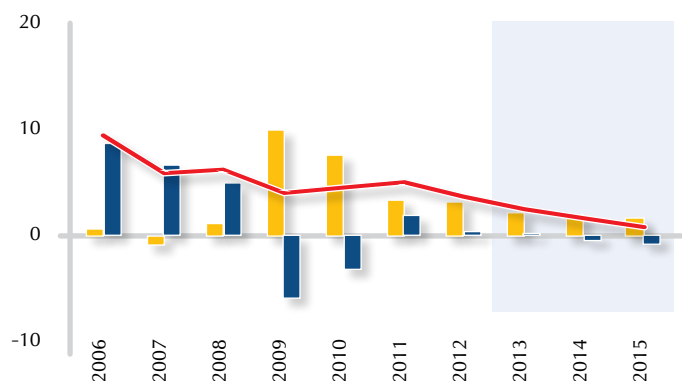
Economic growth:

GDP growth and forecasts of national and international institutions (%)

Source: facts and forecasts of national ministries, EDB, WB, EBRD and IMF

**Savings and investments**

(% of GDP): balance of private savings and investments (Sp-Ip), state budget (Sg-Ig), current account (X-M)

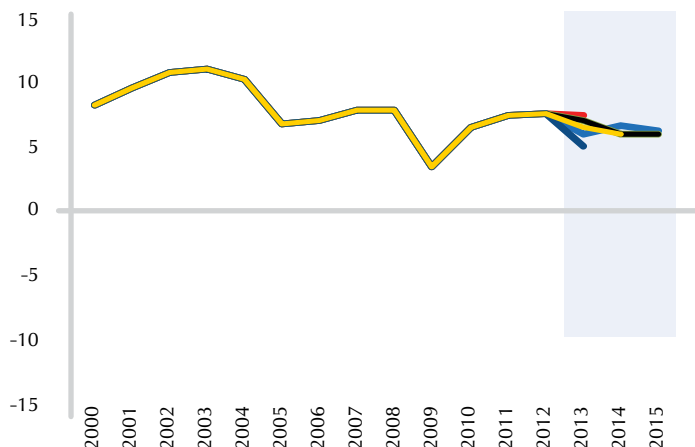


Sp-Ip (private sector)
Sg-Ig (state budget)
X-M (current account)

Key indicators
(statistics and
assessments of
national ministries
and IMF)

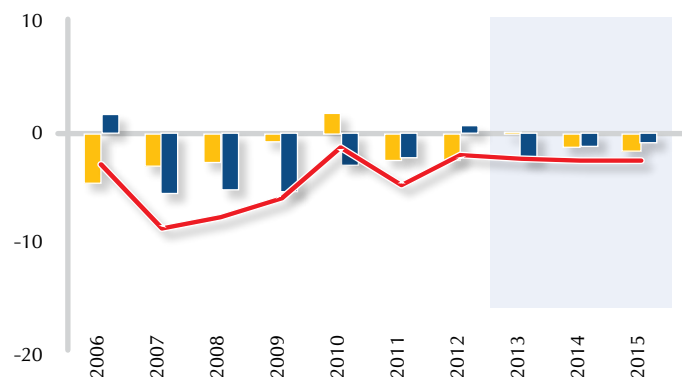
	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	5.6	-7.9	4.5	4.3	3.4
Per capita GDP (\$)	11631	8568	10674	13335	14247
CPI growth (% of the previous year's figure)	13.3	8.8	8.8	6.1	6.6
Government budget (% of GDP)	5.1	-6	-3.1	1.9	0.8
Current account balance (% of GDP)	6.2	4.1	4.6	5.2	4

ECONOMIC SITUATION: TAJIKISTAN



Economic growth:
 GDP growth and
 forecasts of national
 and international
 institutions (%)

Source: facts and
 forecasts of national
 ministries, EDB,
 ADB, WB, EBRD
 and IMF



**Savings
 and investments**
 (% of GDP): balance
 of private savings and
 investments (Sp-Ip),
 state budget (Sg-Ig),
 current account
 (X-M)

Sp-Ip (private sector)
 Sg-Ig (state budget)
 X-M (current account)

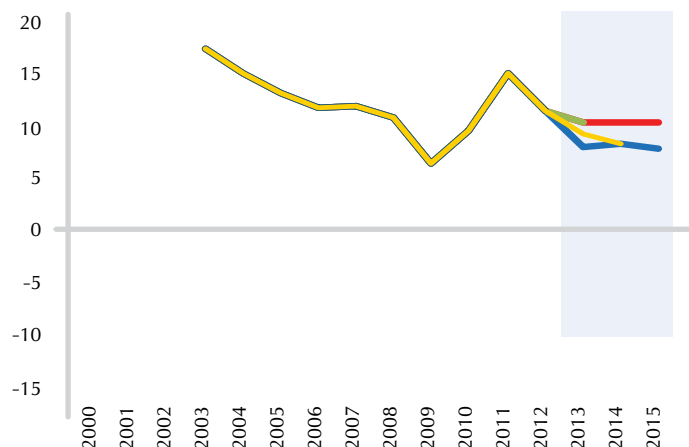
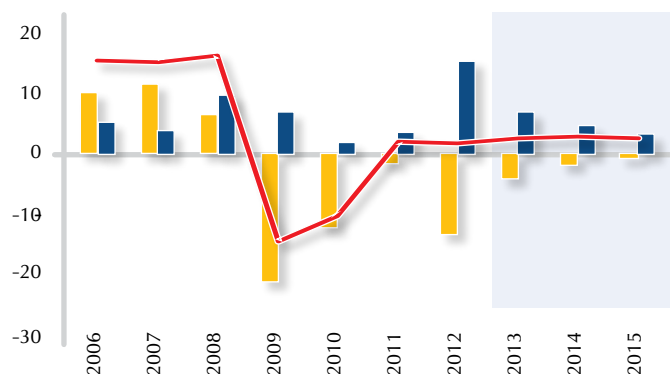
	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	7.9	3.4	6.5	7.4	7.5
Per capita GDP (\$)	696	661	741	836	953
CPI growth (% of the previous year's figure)	11.9	6.2	10	9.4	6.5
Government budget (% of GDP)	-5.1	-5.2	-3	-2.1	0.6
Current account balance (% of GDP)	-7.6	-5.9	-1.2	-4.7	-1.9

Key indicators
 (statistics and
 assessments of
 national ministries
 and IMF)

ECONOMIC SITUATION: TURKMENISTAN

Economic growth:
GDP growth and forecasts of national and international institutions (%)

Source: facts and forecasts of national ministries, ADB, WB, EBRD and IMF

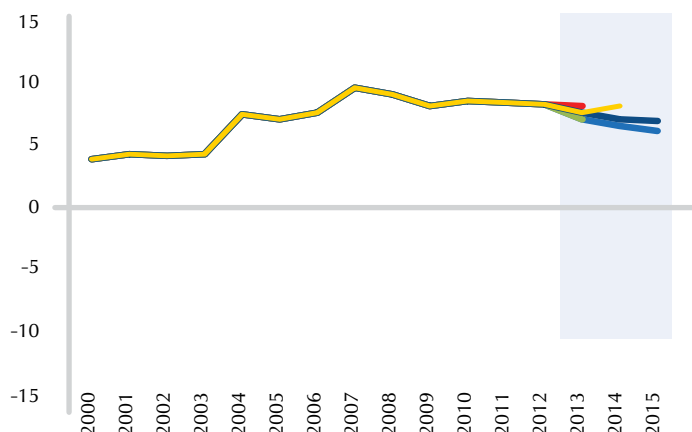
**Savings and investments**
(% of GDP): balance of private savings and investments (Sp-Ip), state budget (Sg-Ig), current account (X-M)

Sp-Ip (private sector)
Sg-Ig (state budget)
X-M (current account)

Key indicators
(statistics and assessments of national ministries and IMF)

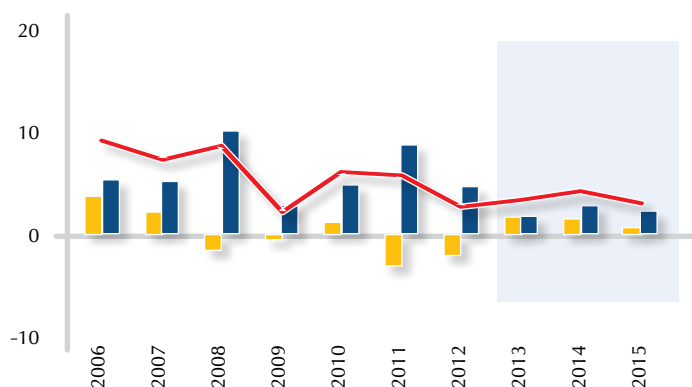
	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	10.5	6.1	9.2	14.7	11.1
Per capita GDP (\$)	-	-	-	-	-
CPI growth (% of the previous year's figure)	-	-	-	-	-
Government budget (% of GDP)	10	7	2	3.6	15.5
Current account balance (% of GDP)	16.5	-14.7	-10.6	2	1.7

ECONOMIC SITUATION: UZBEKISTAN



Economic growth:
 GDP growth and
 forecasts of national
 and international
 institutions (%)

Source: facts and
 forecasts of national
 ministries, ADB, WB,
 EBRD and IMF



**Savings
 and investments**
 (% of GDP): balance
 of private savings and
 investments (Sp-Ip),
 state budget (Sg-Ig),
 current account
 (X-M)

■ Sp-Ip (private sector)
 ■ Sg-Ig (state budget)
 — X-M (current account)

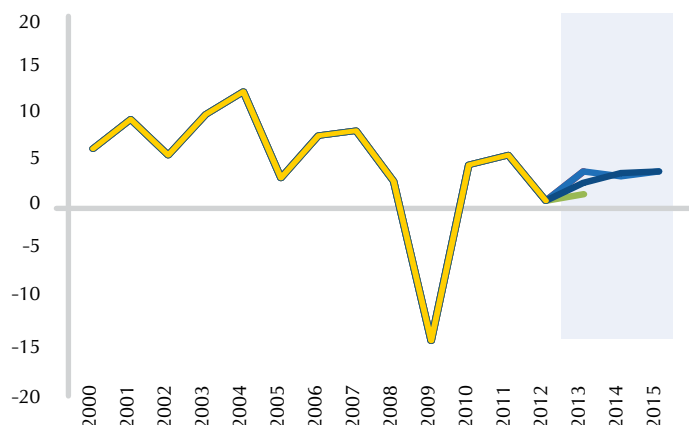
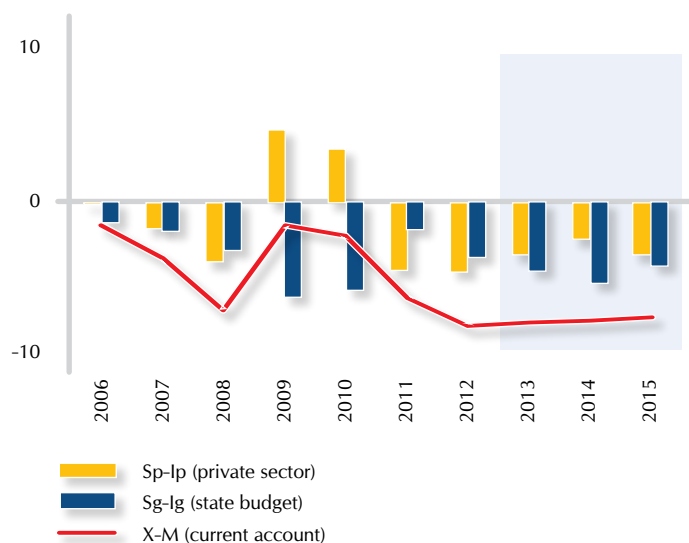
	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	9	8.1	8.5	8.3	8.2
Per capita GDP (\$)	-	-	-	-	-
CPI growth (% of the previous year's figure)	12.7	14.1	9.4	12.8	12.1
Government budget (% of GDP)	10.2	2.8	4.9	8.8	4.7
Current account balance (% of GDP)	8.7	2.2	6.2	5.8	2.7

Key indicators
 (statistics and
 assessments of
 national ministries
 and IMF)

ECONOMIC SITUATION: UKRAINE

Economic growth:
GDP growth and forecasts of national and international institutions (%)

Source: facts and forecasts of national ministries, WB, EBRD and IMF

**Savings and investments**
(% of GDP): balance of private savings and investments (Sp-Ip), state budget (Sg-Ig), current account (X-M)

	2008	2009	2010	2011	2012
GDP growth (% of the previous year's figure)	2.3	-15.1	4.1	5.2	0.2
Per capita GDP (\$)	3899	2550	2980	3584	3877
CPI growth (% of the previous year's figure)	22.3	12.3	9.1	4.6	-0.2
Government budget (% of GDP)	-3.2	-6.3	-5.8	-2.8	-4.6
Current account balance (% of GDP)	-7.1	-1.5	-2.2	-6.3	-8.2

Key indicators
(statistics and
assessments of
national ministries
and IMF):

Chronicle of Eurasian Regional Integration 2012

Natalia
Maqsimchuk

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Monitoring news reports in the leading business publications that touch upon the interaction of the post-Soviet countries gives ample material for reflection. Even a fleeting glance is sufficient to see the inconsistency of the environment in which the countries of the region are seeking opportunities for cooperation. But, despite many obstacles, integration processes are gradually gaining new ground by virtue of efforts at the political level and the actions of the business community.

The high point of the year for the CIS was the entry into force of the Free Trade Agreement (CIS FTA), signed by the CIS member states on October 18, 2011. By the year's end, five out of eight CIS countries, namely Russia, Belarus, Ukraine, Armenia and Moldova, had ratified the CIS FTA. Experts believe that the signing of the FTA may transform the CIS into a set-up platform for more advanced forms of integration. In this light, a new study by the Eurasian Economic Commission (EEC) on restrictive measures against the Customs Union (CU) commodities is of special interest. According to the study, CIS countries account for 38% of all the restrictive measures applied against CU commodities. Ukraine applies 16 measures, including ten anti-dumping ones, while Uzbekistan imposes 15 restrictive measures and discriminatory excise taxes on over 400 items. This practice raises concerns over the FTA's prospects.

Late 2012 was also notable for a breakthrough in the establishment of an integrated currency market among CIS member states – six countries, namely Belarus, Russia, Kazakhstan, Armenia, Kyrgyzstan and Tajikistan, plan to sign the relevant agreement. However, experts believe that, while any measures that remove restrictions on mutual currency conversion or foreign exchange transactions are welcome, there are still a lot of issues and problems to be solved in order to transform the Russian rouble into a reserve currency.

While discussing the transformation of the EurAsEC into the Eurasian Economic Union, the EurAsEC member states failed to agree on the format of the future integration association and some issues of its legal standing. Meanwhile, the process of transferring the CU under the jurisdiction of the Single Economic Space (SES) has continued and the EEC has superseded the CU Commission. News from the CU indicates that the problems surrounding the practical application of CU legislation do exist, but they do not hamper the process of integration of the customs space of Russia, Belarus and Kazakhstan, which is largely credited to businesses' efforts.

The June summit of the Shanghai Cooperation Organisation (SCO) in Beijing uncovered disagreements between the SCO member states. Although regional security is considered a priority for the SCO, Beijing is increasingly promoting the idea of turning the SCO into a union with a focus on the economy. So far Moscow has managed to hold back the consideration of a number of projects that could reduce Russia's weight in the SCO and make China the sole leader of the organisation.

The ambiguous state of affairs in the spheres of military and political cooperation and security enforcement can be easily traced in the news. Uzbekistan suspended its membership of the CSTO, while the US plans to transfer weapons and military equipment, now being used in Afghanistan, to Kyrgyzstan, Uzbekistan and Tajikistan after 2014. These plans raise concerns over their potential impact on the states' interaction within the CSTO. This scenario is unacceptable for Russia for it runs counter to specific agreements with Moscow's Central Asian partners and other agreements within the CSTO framework. Problematic situations emerged in rapid sequence throughout the year. Azerbaijan attempted to raise Russia's lease payment for the Gabala Radar Station. Given the similar claims by Kyrgyzstan and Tajikistan, it is possible to talk about a trend to bargain for concessions from Russia in return for deploying Russian military bases and facilities in the former USSR. Faced with US attempts to put pressure on Russia in Central Asia, Moscow is taking measures to bolster its positions in the region. Russia is prepared to spend \$1.1 billion on rearming Kyrgyzstan's military and \$200 million on military training in Tajikistan. Moreover, Tajikistan will also receive a discount on fuel deliveries from Russia.

Russia and Belarus signed a master agreement on construction of the first Belarusian nuclear power plant. Following a year and a half of negotiations,

the parties have finally reached principal agreements on the KamAZ and MAZ merger. Russia ratified gas agreements with Belarus, while Gazprom plans to increase gas transit via the republic. However, the long-running dispute over zero duty oil supplies from Russia could have grave consequences. Russia's estimated losses caused by a Belarusian solvent smuggling scheme amounted to \$1.5-\$2.5 billion, which is equal to almost 20%-35% of Minsk's financial reserves. The termination of oil product supplies from Belarus to Europe disguised as solvents and thinners had an immediate impact on the foreign trade balance of Belarus, raising concerns over the country's economic prospects and the local currency exchange rate.

Ukraine has been making a more frequent appearance in the news on a variety of occasions. Rospotrebnadzor, Russia's health and consumer rights watchdog, banned the import of around 128.5 tonnes of Ukrainian cheese to Russia. A sharp tussle with Russia over gas prices and the volume of annual gas imports has not led to a revision of the existing agreements. Talks between the Russian energy giant Gazprom and Ukraine's national joint stock company Naftogaz on the future of the Ukrainian gas transportation system (GTS) have yielded no results, while the Ukrainian Parliament adopted a draft law on the reorganisation of Naftogaz that prohibits the privatisation of the GTS. DTEK, Ukraine's largest private energy holding, signed a framework agreement with Russia's INTER RAO UES for electricity supplies to Russia. Russia's Vnesheconombank may become the key investor in the construction of a new metro line in Kyiv. In addition, Russia and Ukraine launched the construction of a plant in Ukraine's Smolino in Kirovograd region to produce nuclear fuel for Ukrainian nuclear power plants, with the project's total cost of \$462.5 million.

Russian-Kazakh relations were relatively trouble-free in 2012, with transport and logistics cooperation on the rise. Sberbank signed a \$2 billion loan agreement with the Eurasia Natural Resources Corporation PLC, which was the first time the metallurgical giant raised funds from a Russian bank. Given the weakening of Ukrainian demand, AvtoVAZ decided to focus on developing Kazakhstan's auto market. Cooperation between Russia and Kazakhstan on the space industry hovered on the verge of frustration; however, the parties managed to successfully resolve the problem.

The telecommunications sector faced an extremely difficult situation in 2012. Subsequent to its troubles in Turkmenistan, MTS faced serious problems in Uzbekistan, which brought to mind the recent Uzbek misadventures of another Russian company, Wimm-Bill-Dann, and its Uzbek subsidiary WBD Tashkent. By the year's end, the court annulled its ruling on the arrest and nationalisation of Uzdunrobita's assets; however, the company will still have to negotiate the reduction of its penalties and recovery of its licence to resume operations in Uzbekistan.

Uzbekistan made an offer to Russia to sign an agreement on mutual cancellation of the recycling fee and agreed to sell gas to Gazprom.

Thus, 2012 in retrospect was a diverse and eventful year, and we continue to monitor future developments.

REGIONAL ORGANISATIONS

CIS

CIS Free Trade Agreement comes into force

September 20, 2012

The Chairman of the CIS Executive Committee, CIS Executive Secretary Sergey Lebedev announced that the Free Trade Agreement of the Commonwealth of Independent States (CIS FTA) signed on October 18, 2011 came into force for Russia, Belarus and Ukraine. The agreement went into effect within 30 days after it was ratified by the parliaments of the three countries. On October 17, 2012, the CIS FTA will also come into force for Armenia, which ratified the Agreement in September. According to Lebedev, other signatory countries to the CIS FTA are currently completing domestic procedures necessary for the Agreement's entry into force.

The first stages of the CIS FTA implementation envisage signature of a number of international agreements that will bring trade and economic relations of the CIS countries to a higher level of interaction. These include the agreement on free trade in services, the agreement on pipeline transit, and the Protocol defining the obligations of the parties with respect to public procurement rules and procedures. Draft agreements have already been developed and are currently being reviewed by the states.

CIS Executive Committee Press Service

Note:

The CIS FTA was signed by Russia, Armenia, Belarus, Kazakhstan, Kyrgyzstan, Moldova, Tajikistan, and Ukraine on October 18, 2011. At the same time, Azerbaijan, Turkmenistan, and Uzbekistan have requested more time to further examine their accession to the Agreement. The CIS FTA aims to create conditions necessary for a full-fledged and efficient functioning of a free trade area within the CIS, and further deepening of integration with due account of the World Trade Organisation guidelines. The CIS FTA will replace the free trade agreements currently in effect between the CIS member states. The Agreement provides for free movement of goods within the CIS, non-discriminatory application of non-tariff regulations, enforcement of the national treatment principle, and clear rules for provision of subsidies in line with international best practice. In contrast to other free trade agreements, the CIS FTA specifies dispute resolution rules that allow for settling breach

of contract cases. According to expert estimates, the creation of the free trade area could more than double turnover volumes between the countries that are signatories to the CIS FTA.

Expert Online, RIA Novosti

April 3, 2012 – Russia ratified the CIS Free Trade Agreement.

RBK

April 19, 2012 – Belarus ratified the CIS Free Trade Agreement.

UNIAN

July 30, 2012 – The Verkhovna Rada of Ukraine ratified the CIS Free Trade Agreement.

RBK

September 11, 2012 – The Parliament of Armenia ratified the CIS Free Trade Agreement.

RIA Novosti

September 27, 2012 – The Moldovan parliament ratified the CIS Free Trade Agreement. Deputy Prime Minister, Economics Minister Valeriu Lazar said this agreement is important for Moldova, as it ensures a stable framework with the CIS countries, which are the main trade partners for Moldova. By that time five out of eight signatory countries to the CIS FTA, namely Russia, Belarus, Ukraine, Armenia and Moldova, ratified the agreement. Uzbekistan intends to join the CIS FTA by the end of 2012.

BELTA, Expert Online

Improving economic dispute resolution policies

September 27, 2012

Minsk hosted the regular meeting of the CIS Council of Chairmen of Supreme Arbitration, Economic and Other Courts, which settle economic disputes.

The meeting brought together members of the Council and the representatives of Azerbaijan, Belarus, Kazakhstan, Moldova, Russia, Tajikistan and Ukraine, as well as representatives of the CIS Economic Court, the EurAsEC Court, the CIS Executive Committee, and the International Union of Lawyers. The participants discussed ways of boosting cooperation between the courts represented in the Council and the CIS Economic Court and EurAsEC Court on judicial dispute resolution practices and uniform use of international agreements in the most important areas of economic relations, as well as on the establishment of a legal platform for cooperation in addressing issues within the EurAsEC contractual and legal remit. The participants also discussed creating an electronic Eurasian judicial network for settling civil and economic disputes, and debated the

role of international courts in developing a unified judicial practice and the necessary legal base for integration associations. They also acknowledged the coordinating role of the CIS Economic Court and the EurAsEC Court in standardising international treaties between courts of the member states of the respective integration associations and reviewed a report by the Supreme Court of Kazakhstan on the practice of administering customs legislation when settling customs disputes in states signatory to the Council's foundation agreement.

CIS Executive Committee

CIS Council of Heads of Government meets in Yalta

September 28, 2012

The CIS Council of Heads of Government met in Yalta to discuss over 20 issues that touch upon various aspects of integration processes within the CIS. The participants of the meeting touched upon the current state of competition in the retail food products market of the CIS member countries, and commended the antimonopoly authorities of the CIS member states and the CIS Interstate Council for Antimonopoly Policy for their ongoing work aimed at ensuring equal opportunities and boosting competition in retail networks.

The meeting's participants welcomed the news on the establishment of the Regional Consultative Group for CIS under the Financial Stability Board to expand cooperation with non-members in the area of financial regulation and supervision in the interest of global financial stability. The Financial Stability Board was created by the G20 in 2009 to coordinate at international level the work of national financial authorities and international organisations in the field of regulation and supervision in the financial sector.

The Council of Heads of Government approved a set of measures for 2012-2014 necessary for the implementation of the Interstate Programme for Innovation Cooperation between the CIS member states for the period to 2020, as well as the CIS Cooperation Strategy to design and develop an information society and the Action Plan for implementation up to 2015.

CIS Executive Committee Press Service

Agreement on cooperation in establishing a CIS integrated currency market drafted

December 24, 2012

Russia's Prime Minister, Dmitry Medvedev, approved a draft agreement on cooperation in creating the integrated currency market of the CIS member states. The agreement was drafted by the Ministry of Finance as part of the implementation of the CIS joint programme of measures to mitigate the after-effects of the global financial and economic crisis in 2009-2010.

The agreement regulates mutual access to national currency markets for the banks resident in the signatory countries to perform interbank conversion operations on equal terms.

Coordination of activities of the competent authorities, as well as the harmonisation of requirements for the integrated currency market participants rests with the CIS authority responsible for the interaction of CIS countries in the monetary sphere.

The CIS member states voiced their intention to establish an integrated currency union during the Ashgabad summit in May 2012. Six countries, namely Belarus, Russia, Kazakhstan, Armenia, Kyrgyzstan and Tajikistan, plan to sign this agreement. Other CIS states that currently refrain from signing the agreement may join later after having considered its economic viability. The establishment of the integrated currency union gives participants to an interstate transaction another advantage to freely choose the currency of payment.

Expert Online

EURASEC

EurAsEC Anti-Crisis Fund may invest in Russia-Belarus-Ukraine road project

February 21, 2012

According to the managing director of the EurAsEC Anti-Crisis Fund (ACF), Sergey Shatalov, the ACF has almost completed the preparation of project documentation for the modernisation of the road connecting Belarus, Russia and Ukraine. Belarus applied for a loan of \$408 million to upgrade the section of the Minsk-Gomel-Ukrainian border road that links with the Moscow-Kyiv highway.

However, Shatalov reminded that in late November 2011 the ACF Council reached a decision to suspend consideration of all investment projects till May 2012 "due to a sharp escalation of global markets' volatility last autumn". According to him, nine applications by five member states for a total of \$4.2 billion in investment and financial loans are currently being considered by the ACF, with two of the applications related to the modernisation of the energy sphere in Central Asia.

Note:

The EurAsEC Anti-Crisis Fund of \$8.513 billion was established by the governments of six countries on June 9, 2009 with the aim of assisting member states in mitigating the after-effects of the global financial crisis and securing their financial and economic sustainability, as well as to support integration processes in the region. The EDB acts as fund manager.

BelaPAN

EurAsEC summit results in signing of nine documents

December 19, 2012

Following the results of the meeting of the Supreme Eurasian Economic Council, the superior body of the Customs Union and the Single Economic Space, the EurAsEC member states inked nine documents, including, inter alia, documents on implementing key integration priorities, on eliminating the Customs Union Commission, and on amending the decision of the EurAsEC Interstate Council dated November 27, 2009.

The participants of the meeting amended the list of sensitive items, any alterations in import duties of which are subject to a unanimous decision by the Customs Union Commission. In addition, they signed documents on the progress made to date in implementing the agreement on common principles and rules of natural monopoly regulation, on initiating negotiations with Vietnam over the free trade agreement, on a concerted approach to implementation of the free trade agreement dated October 18, 2011, and on approval of the criteria for cross-border type markets.

Expert Online

CUSTOMS UNION

Constitution thwarts Ukraine's accession to Customs Union

March 22, 2012

Ukraine's accession to the CIS Customs Union, which currently embraces Russia, Belarus and Kazakhstan, would run counter to the national Constitution, President Viktor Yanukovich said. He went on to say that in the event that Ukraine wanted to join the CU, the national Constitution would have to be altered in a legal way, either in parliament or at a national referendum. Yanukovich explained that in accordance with the country's Constitution, Ukraine does not have the right to join the organisations that have supranational regulatory agencies.

Moscow invited Kyiv to join the CU and the Eurasian Union, saying that the country could benefit from a significant discount on Russian energy resources. However, the country is so far ready to cooperate with the CU only on a 3 + 1 basis. According to Yanukovich's earlier statements, Ukraine's accession to the CU will depend on its efficiency.

Expert Online

Ukraine inks trade cooperation memorandum with CU

August 30, 2012

Ukraine is stepping up cooperation with its post-Soviet trading partners, in particular with the CU member states. Following the ratification of the free trade agreement with the CIS, Kyiv and Moscow signed a memorandum on trade cooperation that forms a system and infrastructure for exchange of information and procedures to carry out a comprehensive policy and address key issues without harming the business and investment climate. A civilised way of settling trade disputes between the countries is the most important phase of new collaboration.

The WTO accession offered Russia an opportunity to resolve disputes through Geneva. However, the arbitration board is a faster and cheaper way of dispute resolution with Kyiv. The countries have already made their first progress in removing trade barriers and agreed to liberalise the import of Ukrainian steel and stainless pipes to the CU member states. The arbitration will help Kyiv and Moscow to further address the issue of exceptions for certain groups of goods that are specified in the CIS free trade agreement.

Expert Online

EBRD praises Russia's success in CU

November 8, 2012

According to the EBRD's Transition Report 2012, Russia's outlook for growth remains highly dependent on commodity prices, while the eurozone developments trigger contraction in export demand and investments. Other vulnerabilities stem from significant private external debt of around \$500 billion, or over 25% of GDP, and possible delays in structural reform implementation.

The EBRD experts noted the relative stability of the financial system. At the same time, the oil and gas sector has deteriorated over the last year, and mining is still characterised by a non-competitive environment and a high degree of over-regulation. Telecommunications and power generation are somewhat similar to the same segments in developed markets, the EBRD experts said. They revised upward their assessment of the rail transportation sector and welcomed the widening of the exchange rate corridor and the establishment of a central securities depository.

The report pays special attention to the development of two regional integration associations – the CU and EurAsEC. According to the EBRD, the launch of the CU made it possible to remove tariff barriers, as well as to significantly lower non-tariff restrictions. As a result, in 2009–2011 trade turnover between the CU member states increased by 70%, and in the first five months of 2012 it continued to expand at the rate of 15.5% year on year. At the same time,

technical and sanitary regulations are yet to be harmonised. Furthermore, there is a clear need to reduce non-tariff barriers in respect of export and import trade between CU members and other countries.

Kommersant

Vietnam, CU mull free trade area

November 8, 2012

Negotiations on a free trade area between Vietnam and the countries of the CU will begin on January 1, 2013, the Russian Prime Minister Dmitry Medvedev said during his official visit to Hanoi.

Speaking about joint projects, Medvedev mentioned plans to build the first nuclear power plant (NPP) in Vietnam. The Ninh Thuan 1 NPP will consist of two power units with VVER-type reactors of 1.2 GW each. The first power unit is expected to be commissioned in 2020 while the construction is to commence in 2014.

In addition, Russia and Vietnam are studying prospects for shelf cooperation in the South China Sea and elsewhere, including the Russian Federation, in a drive to boost cooperation in oil production. Another promising area of cooperation is the supply of liquefied natural gas to the Vietnamese market and other markets adjacent to Vietnam. Even in light of the current high investment risks, Russia's present-day investment in Vietnam is targeted investment in a strategic region – the widening of trade relations with Vietnam as one of the economic leaders of the Asia-Pacific opens up additional perspectives for Russia. In particular, cooperation in the field of nuclear energy will allow Russia to gain a foothold in the region, which is so far the most promising in terms of nuclear power and fuel-and-energy sector development.

Note:

At present Vietnam accounts for 0.4% in Russia's foreign trade turnover, buying metals, chemicals, industrial machinery, fertilisers and gasoline, and selling textiles, electronics and foodstuffs. Large-scale joint projects include the development of oil and gas fields on the Vietnamese shelf with the participation of Gazprom and Zarubezhneft, and the construction of a nuclear power plant by Rosatom in Ninh Thuan province.

Expert Online, Vedomosti

Residence principle to be abolished in CU after 2015

November 12, 2012

Problems with the practical application of the CU legislation do exist; however, they do not hinder the process of integrating the customs space of Russia,

Belarus and Kazakhstan. Some of the outstanding issues touch upon freight transit. After the introduction in June 2012 of compulsory prior notification of shipments arriving at the border, representatives of the business community brought up the issue of creating a single CU portal for submitting such data in order to unify the customs requirements for documents that currently differ from country to country.

Customs officials of Belarus and Kazakhstan acknowledge the importance of a single portal, but have no technical means to ensure its fast implementation – creation of a portal is scheduled to begin only in 2015.

In addition, the CU needs to speed up the procedure of export confirmation for VAT refunds to exporters. This mostly concerns Kazakhstan, given the lack of automated information exchange with the customs authorities of the country.

Moreover, measures should be taken to resolve problems in the transportation sphere. Out of 173,000 cargo trucks from Belarus inspected at Russian transport control points during the ten months of 2012, 57,000 (33%) had various violations, including a lack of transportation permits, overload, etc., even though all of the trucks passed the Belarusian transport inspection at the CU border.

However, the major unresolved problem for businesses is the "residence principle", requiring that the unloading of the goods imported into the CU can be made only in the country of the importer's residence. The Eurasian Economic Commission (EEC) identified and analysed 12 reasons hampering the abolishment of the residency requirement, including the insufficient harmonisation of certain aspects of tax, foreign currency and other legal standards. The Governments of the three countries have been informed of these issues and are expected to resolve them before the foundation of the Eurasian Economic Union in 2015.

Kommersant

Yanukovych cancels Moscow visit

December 18, 2012

A visit to Moscow by Ukrainian President Victor Yanukovych has been unexpectedly postponed a few hours before negotiations between Yanukovych and Russian President Vladimir Putin were due to begin. The Ukrainian President's press service reported that the Presidents were to focus on drafting a mutually acceptable mechanism for cooperation between Ukraine and the Customs Union of Russia, Belarus and Kazakhstan. Moscow and Kyiv were expected to sign an array of documents on Ukraine's cooperation with the CU. Ukraine proposed to reschedule the meeting to sometime in 2013.

Meanwhile, the Ukrainian opposition wasted no time putting a political spin on the news of the cancelled trip, even attempting to take credit for Yanukovych's

last-minute cancellation – the opposition would demand Yanukovych be called to account if he signed any agreement on Ukraine’s accession to the CU while in Moscow.

Joining the CU is a matter of survival for Ukraine, believes Sergey Glazyev, adviser to the Russian President. Given the absence of export and import duties within the framework of the CU, Ukraine would first of all benefit from the abolition of duties on oil and gas deliveries if it joins the CU. Glazyev underlined that within the CU the terms of trade for Ukraine would improve by \$9 billion, which is particularly important, given the country’s balance of payments deficit of more than \$5 billion.

Vedomosti.ru

SINGLE ECONOMIC SPACE

Kazakhstan signs law on Eurasian Economic Commission

January 10, 2012

Kazakh President Nursultan Nazarbayev signed the law “On the Ratification of the Agreement on the Eurasian Economic Commission”. The EEC is based on a two-tier management structure consisting of the Council and the Board. The Commission’s budget will be formed of the member states’ contributions proportional to the distribution of collected import duties, set by the respective agreement dated May 20, 2010: 4.7% for Belarus, 87.97% for Russia and 7.33% for Kazakhstan.

From January 1, 2012 the Board became the EEC’s new supranational authority, responsible for integration processes within the CU, and starting July 1, 2012 the EEC will supersede the CU Commission.

Note:

Russia ratified the Agreement on the Eurasian Economic Commission on December 1, 2011, and the Parliament of Belarus ratified the Agreement on December 8, 2011.

zakon.kz, Kommersant, UNIAN-Economy, trade.gov.kz

Eurasian Economic Commission widens supranational authority

February 28, 2012

The Eurasian Economic Commission (EEC) will gradually expand its “supranational” powers in regulating trade, investment and interaction with the EurAsEC external partners, said the EEC Minister for Trade Andrei Slepnev during a meeting with academic personnel at the Higher School of Economics.

The potential of integration association is estimated at 170 million members and \$500 billion annual turnover (the Russian economy accounts for 87% of the total EurAsEC resources). Starting January 2012 when the EEC and the EurAsEC court became operative, 17 regulatory agreements were put into effect; however their full-fledged implementation will take another 5-7 years. A single document, intended as the constitution of the EurAsEC, should be formulated by 2015.

Meanwhile, the EEC expects to sign a framework agreement with the Association of Southeast Asian Nations (ASEAN) in the short term. The establishment of free trade areas with a number of countries in the Asia-Pacific Economic Cooperation (APEC), in particular with Vietnam, is also under discussion. At present the APEC's share in Russia's total export is just under 30%, while Russia's import from the APEC is about 20%.

According to Slepnev, the reduction of the administrative burden on the EEC decision-making process may have a positive impact on the economy of the Russian Federation. "Competing jurisdictions" will help develop the most effective solutions for many issues. Russia has a lot to learn, for example, from Kazakhstan – the state is ranked 47th in the World Bank's Doing Business-2011, while Russia is 120th.

In the meantime, Kazakhstan reaps the undisputed and most significant benefits from greater integration in the EurAsEC, with businesses from Russian border regions moving to Kazakhstan.

Kommersant-Online

EurAsEC fails to agree on establishing Eurasian Economic Union

March 21, 2012

Moscow hosted the summit of the EurAsEC member states, focusing on the transformation of the organisation into the Eurasian Economic Union. In his opening remarks, the President of Russia, Dmitry Medvedev, stressed that the main issue on the summit's agenda is the implementation of agreements reached during the EurAsEC Interstate Council meeting dated December 19, 2011 on the restructuring of the organisation. Following the results of the summit, Medvedev noted that the reorganisation of the EurAsEC will be discussed during the next summit, after the presidents of the member states have held additional consultations.

The dissolution of the EurAsEC was hindered by the legal framework, as the parties failed to agree on the format of the future integration association and some issues of its legal standing. In particular, Russia suggested naming a new organisation the "Eurasian Economic Union" (EEU), while Belarus stood for the "Eurasian Common Economic Space" (ECES).

Experts agree that the parties need to decide on how the union will evolve, how quickly and exactly in which areas it would operate. In any case, talks on economic integration tend to be very lengthy. As for the post-Soviet space, the process of economic integration has always been very inconsistent. EurAsEC represents quite a successful form of interaction; however, transition to a closer integration quite naturally runs into controversy among participants. The key issue is how to achieve a reasonable balance between the interests of individual states and the interests of the association they are members of.

Expert Online

EEC adapts customs tariff to WTO

July 20, 2012

The EEC has eventually approved new customs duties rates and commodity nomenclature, adjusted to the agreement on Russia's accession to the WTO.

The Moscow meeting of the EEC Council ratified a new single customs tariff of the Customs Union (CU SCT) and a new Foreign Economic Activity Commodity Nomenclature (FEACN), approved by EEC Board decision no. 101 on July 5. These basic documents will apply to the calculation of import duties for all goods imported into the customs territory of the CU.

The revised CU SCT and FEACN are harmonised with the WTO requirements and are based on the Harmonised Commodity Description and Coding System 2012, introduced in the CU on January 1, 2012. The amendment drafting has lasted for the past year – a moratorium on local changes to the CU SCT was introduced in mid-2011 – and resulted in a reduction of customs duties on about 1,000 commodity items, including foodstuffs, carpets, clothes, ferrous metals goods, and motor vehicles. Meanwhile, the customs duties on around 25% of the total commodity items may be raised to match tariff commitments, providing additional opportunities to reduce the negative effects of Russia's accession to the WTO for individual industries and manufacturers, explained the EEC Minister for Trade, Andrei Slepnev. According to preliminary estimates, the new CU SCT will drive the average import duty rate down from the current 9.6% to 7.5%-7.8%. In addition, the new tariff specifies around 120 tariff positions, which envisage exemptions for Belarus and Kazakhstan, as non-members of the WTO.

The revised CU SCT and FEACN will be published after Russia finalises its accession to the WTO, and will become effective 30 days after publication.

Kommersant-Online

IX Russia-Kazakhstan Interregional Cooperation Forum bears fruit

October 1, 2012

Pavlodar hosted the ninth Russia-Kazakhstan Interregional Cooperation Forum, which has become an effective tool for strengthening and developing trade and economic relations between the two countries. The forum resulted in the signing of several investment agreements for a total amount of \$2 billion. Moreover, Russian auto giant AvtoVAZ voiced its plans to launch a production site in Ust-Kamenogorsk by 2014 in cooperation with JSC Azia Avto and Yertys Social and Entrepreneurial Corporation. Total investments in the project will amount to \$400 million. The launch of construction of a third power unit at Ekibastuz GRES-2, which is owned by Samruk-Energy and INTER RAO UES on an equal basis, was also announced during the forum (planned investments amount to \$1 billion). Moreover, a subsidiary of Russian EuroChem has once again stated its intention to invest \$2 billion in a plant in Zhambyl region to produce phosphoric, nitrogen and combined fertilisers.

Expert Online

SCO

SCO summit uncovers disagreements between Russia and China

June 7, 2012

The regular summit of the Shanghai Cooperation Organisation took place in Beijing. The Summit brought together the heads of the SCO member states and delegations from observer states, i.e. Mongolia, Iran, Pakistan and India, as well as the EurAsEC, CIS and CSTO leadership and the Special Representative of the UN Secretary General. The presidents of Afghanistan and Turkmenistan also participated in the summit as guests of the host country.

The SCO member states approved a programme for cooperation in the field of combating terrorism, separatism and extremism for 2013-2015, and a revised version of the SCO regulations on political and diplomatic measures and mechanisms of response to events jeopardizing regional peace, security and stability, as well as main guidelines for the SCO medium-term development strategy and a declaration on building a region of lasting peace and common prosperity.

www.sectSCO.org

The 12th SCO summit has resulted in expanding the SCO's zone of influence in the neighbouring regions through admitting Afghanistan as an observer country and Turkey as a dialogue partner, and via increased interaction with Iran and other regional players.

However, despite declarations on boosting the SCO role in enhancing security beyond its borders, the Beijing Summit showed that the organisation has actually divided into “groups of interest” and turned into an arena of rivalry between Moscow and Beijing. Although both Russia and China consider regional security a priority for the SCO, Beijing is increasingly talking about economic integration within the organisation, aggressively promoting the idea of turning the SCO into a union with a focus on the economy. Moscow managed to delay consideration of a number of projects that could reduce Russia’s weight in the SCO and make China the sole leader of the organisation, including establishment of a development bank and a special SCO fund as a regional analogue of the IMF, as well as the SCO free trade area. If all three projects were to be implemented, given an impending second wave of the crisis and a drop in oil prices, then cheap Chinese money allocated within the framework of the SCO would become an additional temptation for many members of the organisation, while Beijing would be well placed to dictate its terms on many issues, including those indirectly related to the SCO activities. Russian diplomats were able to persuade colleagues that deciding on these projects during the current summit would be premature. In addition, the summit participants supported Moscow’s position on the situation in Syria and Iran.

Despite a tactical victory, Moscow will have hard times ahead dealing with the growing influence of China in the SCO. Even if China does not gain the levers of SCO financial management, Beijing will be able to issue loans to member countries on a bilateral basis, just as in the last few years.

Kommersant

SCO needs a development bank

December 10, 2012

The Heads of Government of the SCO member states gathered for a summit to discuss various economic issues, including the development of transport infrastructure, support of small and medium-sized businesses, as well as intercultural and interbank cooperation.

The summit participants agreed to establish a development bank and a special fund within the SCO; however there is still no information on the fund size, contributions or its operating principles. Prime Ministers of Kazakhstan and Russia, Serik Akhmetov and Dmitry Medvedev, underlined the need to speed up the creation of such a fund to finance the joint projects of the SCO member states. According to Medvedev, the SCO countries have achieved success in confronting the challenges of the global economic crisis; however, it is quite possible that the global economic slowdown may nevertheless affect the SCO countries. Moreover, Russia suggested boosting the development of transport and logistics corridors, while China expressed readiness to invest up to \$10

billion in energy and industry. In addition, Kazakhstan and China underlined the importance of maintaining the positive dynamics of bilateral trade with the prospect of growth to \$40 billion in 2015.

Expert Kazakhstan

TRADE AND INVESTMENTS

Kazakhstan's accession to WTO may streamline CU trade with other countries

February 1, 2012

Russia became the only country that has signed the WTO agreement, being in a customs union with countries that are not members of the WTO. Russia's accession to the WTO imposes a commitment on its CU partners to adopt the WTO norms, and eventually join the organisation, Maksim Medvedkov, head of the Department for Trade Negotiations of Russian Economy Ministry said during the presentation of the report "Russia and the WTO: Results and Prospects".

However, it is possible that Russia will have to additionally liberalise its foreign trade. In May 2011, the CU states signed the Treaty on the Functioning of the Customs Union, which inter alia aims to govern the actions of the participating countries in the event that one of them joins the WTO. According to the agreement, "starting from the date the CU member state joins the WTO the single customs tariff of the CU will not exceed the rates of import tariff, except in cases provided by the WTO agreement". Moreover, before the relationship under the CU is brought into conformity with the WTO requirements, "WTO norms take precedence over the relevant provisions of international agreements signed within the framework of the CU".

Meanwhile, according to Medvedkov, the main obstacle to the unification of the terms of trade in the CU with the standards of the WTO is that Kazakhstan has negotiated its WTO accession in parallel with Russia and has already agreed to more liberal terms of trade than those Russia "bargained" in 2011. According to the aforementioned CU agreement, in such cases the parties should without delay hold negotiations with each other and with members of the WTO whose interests are affected by such divergence.

If Russia insists on Kazakhstan's waiver from "unacceptably liberal" WTO proposals, it will substantially hamper the process of negotiation with third countries and under a hard negotiation scenario may even jeopardise the very existence of the CU. Thus, it is most likely that a compromise between Russia, Kazakhstan and the WTO will lead to additional liberalisation of the CU's terms of trade.

Kommersant

Customs integration has not yet led to emergence of a common investment space

March 5, 2012

Despite some economic benefits of the CU established two years ago, customs integration of Russia, Belarus and Kazakhstan has not yet led to the emergence of a common investment space. Though the CU introduced a number of common requirements, only the terms and conditions of the initial investor's access to the market of the CU member states have been standardised after all, while the business environment, taxation schemes, preferences, etc. are still being determined by national regulatory enactments. Consequently, the investment climate is not uniform: given the difference in tax assessment and conditions offered to investors, separate "climate zones" remain within the territory of the CU. In addition, national legislations have not yet provided any benefits to investors from other CU countries, though, according to experts, some preferences in this sphere could facilitate the inflow of funds.

Expert

EEC launches first special safeguard investigation

July 9, 2012

The EEC launched its first special safeguard investigation into the import of combine harvesters to the CU. The case was filed by Russian Rostselmash and Kransoyarsk Combine Plant, which account for a total of 49.6% of all combine harvesters produced in the CU, and supported by Belarusian Gomselmash and Lidagroprommash. All four companies account for an aggregate 95.9% share in the total production of combine harvesters in the CU. The companies complained that the CU's harvester market has shrunk by 19.5% in 2009-2011, while local production fell by 6.9%, sales by the aforementioned companies contracted by 23.1% and their market share decreased by 4.1%. At the same time, harvesters' import increased by 20.5% during the same period, and the average price of the imported harvester (excluding import duty) fell by 18.6%.

The EEC underlined that the investigation is being carried out in accordance with WTO regulations. The process could take six-nine months and may result in the introduction of a special safeguard duty on import or other protective measures.

Vedomosti

Trade blooms without borders

July 12, 2012

The agreement on establishing the CU was signed in November 2009 and resulted in harmonisation of import tariffs in January 2010 and transfer of

customs controls to the CU's external border on July 1, 2011. Starting from 2010, trade turnover between Russia, Kazakhstan and Belarus is growing rapidly, having increased by 66% in 2010-2011 and by 18% in the first quarter of 2012 (compared to the same period of 2011), to \$223.2 billion, according to the EBRD estimates.

In 2010, Russia's turnover with the other CU members grew at about the same rate: by 18.9% to \$15.2 billion with Kazakhstan and by 18.8% to \$27.8 billion with Belarus, while in 2011 trade with Belarus increased more rapidly (by 38% to \$38.6 billion) than with Kazakhstan (by 29% to \$19.7 billion, Rosstat). Russian imports from Kazakhstan increased by 53% and exports by 19%, while exports to Belarus grew by 38%, and imports by 39%.

According to forecasts, the creation of the CU and SES will boost trade between the three countries by 70%, to \$400 billion by 2015.

According to EBRD experts, the reduction of non-tariff barriers, including the abolishment of customs controls along the common borders and simplification of imports and payment system have become major factors driving trade growth. Countries still need to harmonise technical regulations, certification procedures and sanitary control standards, while liberalisation of the service sector and facilitation of mutual access to markets of the CU member states will reveal key benefits from the creation of the CU.

Vedomosti

Ukraine to privatise its titanium industry

August 13, 2012

Ukraine, the world's fifth-largest titanium producer, has decided to privatise its titanium assets. In late July, Ukrainian President Viktor Yanukovich excluded Volnogorsk Mining and Metallurgical Integrated Works, Irshansk Mining and Processing Integrated Works, Zaporozhye Titanium & Magnesium Combine and 50% plus 1 share of Crimea Titan PJSC from the list of enterprises not subject to privatisation, due to the industry's urgent need of about \$2-\$2.5 billion in investment. The listed assets may be of interest to the world's largest titanium manufacturer – Russia's VSMPO-AVISMA, which is controlled by the state corporation Russian Technologies. However the company's decision to participate in the privatisation process will depend on the tender offer. VSMPO has a rich experience of working in Ukraine through its subsidiary VSMPO Titan Ukraine Ltd.

VSMPO is particularly interested in acquiring a stake in Zaporozhye Titanium & Magnesium Combine, the largest manufacturer of titanium sponge (a semi-finished product for titanium and titanium alloy goods) and one of VSMPO-AVISMA's principal competitors and suppliers. Experts believe that, given

VSMPO's high debt load, state assistance will be needed if the company takes part in privatisation. However it is worth fighting for the assets as they will help solve VSMPO's problems with raw materials.

Vedomosti

VEB launches first transport project outside Russia

September 18, 2012

OJSC Federal Centre for Project Finance, a subsidiary of Russia's Vnesheconombank (VEB), won the tender for investment advice services for the construction of a fourth metro line in Kyiv on conditions of a public private partnership. The \$1.5 billion project foresees the construction of 12 new stations. VEB may become the key investor in the construction of a new metro line, expecting to engage its Ukrainian subsidiary, Prominvestbank, in the project, while VEB Capital will be responsible for setting up a consortium of investors. The project's prime contractor may co-finance the construction.

The parties have not yet decided on the financial model of the project, choosing between a concession agreement and a life-cycle contract (LCC). While in the first case the investor's recoupment depends directly on the passenger fares collected, and the city officials are unwilling to raise the metro fare significantly, the key feature of the LCC is that the contractor builds the line at its own expense, and the state begins to pay only from the date of the project's commissioning, actually providing government guarantees. Currently, Kyiv's budget foresees \$100 million a year for the needs of the metro construction. In addition, VEB will be able to partially recover money invested via building developments around the metro stations. World practice shows that such projects can cover up to 20% of the project's construction costs.

Kommersant

Who hinders the CU of Russia, Belarus and Kazakhstan?

December 3, 2012

The EEC drew up a list of countries applying restrictive measures against the CU commodities. The European Union and the United States topped the list, followed by Ukraine, with Uzbekistan third. Because of Ukrainian restrictions alone the CU loses about \$200 million a year. A total of 105 restrictive measures are applied in relation to the countries of the CU, including 44 anti-dumping measures, 13 excise duties, 12 economic sanctions, five administrative barriers and additional charges, and four quota restrictions. Non-CIS countries account for about 62% of restrictions, with the EU and the US in the lead (18 measures each). For instance, the EU applies six anti-dumping measures on imports of pipes and chemical products, and also limits the supply of grain, textile products and nuclear cycle components. The US imposes eight economic sanctions on

Belarusian commodities, several anti-dumping measures against chemical and metallurgical products from Russia and Belarus, and severely limits the import of weapons from Russia. India applies eight and China six measures on chemical products from the CU.

CIS countries account for 38% of restrictive measures. Thus, Ukraine applies 16 measures, including ten anti-dumping ones on fibreboard, glass, methanol, etc. Uzbekistan imposes 15 restrictive measures and discriminatory excise taxes on more than 400 commodity items (flour, confectionery, meat and sausage goods, vegetable oils, sugar, beer), setting excise duty on dairy products from the CU at a rate of 70% and on sausage goods at 30%. Moreover, Uzbekistan applies administrative sanctions. Consequently, the exchange of national currency to freely convertible currency is delayed by an average of 3-12 months, while consumer loans are available only for purchasing locally produced goods.

RBK Daily

Kazakhstan invests in Russian Internet projects

December 7, 2012

Fastlane Ventures (FLV), the leading Russian Internet investor and operational partner in online businesses, secured an investment of \$13 million from Kazakhstan's leading technology investor, Kenes Rakishev, in addition to \$78 million raised earlier from Russian and international investors, including Intel Capital, eVenture Capital Partners, Kinnevik, Runet Holding, Direct Group and VTB Capital. Rakishev joined the FLV Board of Directors.

According to Rakishev, he studied different options for entering the Russian market and decided on a partnership with FLV. In spring 2012 Rakishev acquired \$32 million in Net Element stock (14.3%), a global technology-driven group specialising in online advertising and distribution of content in mobile networks. Moreover, Rakishev also invested in a number of international technology start-ups, including Mobli, a real-time media visual platform (\$20 million), and TriPlay, a premier cloud services company (\$5 million).

The funding will be spent on launching new startups and increasing FLV's number of portfolio businesses.

Vedomosti

Tajikistan joins WTO

December 11, 2012

Tajikistan has been officially admitted to the World Trade Organisation. At a ceremony in Geneva on December 10, WTO Director-General Pascal Lamy and Tajik President Emomali Rahmon signed three documents: the protocol on Tajikistan's admission to the WTO, the decision of the WTO General Council

on approving Tajikistan's accession, and working group's report on Tajikistan's accession.

Representatives of the US, EU, China, India, Korea, Saudi Arabia, Kyrgyzstan, Dominican Republic, Switzerland, Ukraine, Turkey, Japan, Paraguay and Bangladesh congratulated the Tajik delegation on completing the accession process.

Expert Online, RIA Novosti, news.tj

Uzbekistan asks Russia to cancel its recycling fee

December 14, 2012

Following Ukraine, which has been negotiating with Russia on the abolition of a recycling fee on car imports for several months already, Uzbekistan made a proposal to Russia to sign an agreement for neither country to apply the recycling fee.

Recycling fees on new and used cars imported into Russia came into force on September 1, 2012. The introduction of fees was driven by Russia's accession to the WTO and the reduction of import duties on vehicles from 30% to 25%, with a subsequent gradual decrease.

Recycling fees triggered a rise in prices for Uzbek cars and significantly worsened their availability to the Russian market. By requesting cancellation of the recycling fees, Uzbekistan is lobbying for the interests of UzDaewooAuto, which produces Daewoo and GM cars.

Uzbekistan's move coincided with the announcement of the price of a new Chevrolet Cobalt assembled in Uzbekistan. The bottom-end model would cost the Russian buyers 444,000 roubles, while the high-end model is estimated at 530,000 roubles. Chevrolet Cobalt is expected to replace the popular Chevrolet Lacetti, which has recently been discontinued at Kaliningrad's Avtotor. According to GM, since 2004 Russia has sold 276,800 Chevrolet Lacetti cars. Cobalt sales plans in Russia are not disclosed.

RBK Daily, ITAR-TASS

BILATERAL RELATIONS

RUSSIA-UKRAINE

Russia bans cheese imports from Ukraine

February 15, 2012

The Russian consumer rights watchdog Rospotrebnadzor imposed a ban on the import of around 128.5 tonnes of Ukrainian cheese for violations of Russian milk and dairy product standards.

Rospotrebnadzor suspended cheese supplies by three Ukrainian producers – Prometey (Chernihiv region), Pyriatyn Cheese Factory and Gadyachsir (Poltava region). Their previously supplied products are being removed from the market on the grounds that they allegedly violate Russia's milk and dairy products standards as they contain vegetable oils not mentioned on the products' labels. However, the Ukrainian manufacturers claim that their products meet all necessary requirements and are ready to provide Russia with test samples of their cheeses.

According to Rospotrebnadzor, Russia is currently in talks with the representatives of Ukrainian Agriculture Ministry on the resumption of cheese supplies to the Russian market. Rospotrebnadzor tested 274 samples from Ukrainian cheese producers for compliance with technical regulations.

RIA Novosti, Expert Online

New draft gas agreement may help reach a compromise

February 21, 2012

The Russian delegation visited Ukraine to hold talks on energy resources, the CU and the admission of Ukrainian cheese to the Russian market.

Russia offered Ukraine a new draft gas agreement that may well settle the gas dispute between the two countries.

Russia is trying to drag Ukraine into the CU. Ukraine, however, seeks to cooperate with the CU (Russia, Belarus and Kazakhstan) on a 3+1 basis. Meanwhile, the CIS free trade agreement has not raised any objections on the part of the Verkhovna Rada of Ukraine. The document was signed by all the CIS heads of Government in October 2011 in St. Petersburg.

Expert Online

Russia and Ukraine fail to settle the Azov-Kerch water issue

July 12, 2012

Russian President Vladimir Putin and his Ukrainian counterpart Viktor Yanukovich held talks in Yalta but failed to make any progress on the demarcation of their borders in the Sea of Azov and the Black Sea. The parties are to settle the ownership of several disputed territories, including the Pallas oil and gas area on the Black Sea shelf, the Tuzla Island in the middle of the Kerch Strait and the Kerch-Yenikal Channel.

In the summer of 2003, a bitter dispute broke out between Russia and Ukraine over the Tuzla Island, when Moscow and Kyiv suggested two mutually exclusive approaches to determining the status of the territory. Kyiv insisted that, being an island, Tuzla represents an integral part of Ukraine, while

Moscow attributed the island to the so-called Spit of the Taman Peninsula that belongs to Russia. Historically, Tuzla was part of the Taman Peninsula, until in 1925 when fishermen dug a small channel, isolating the island. In 2003, the Krasnodar authorities tried to construct a dam between the Taman peninsula and Tuzla, but were forced to suspend construction under pressure from Kyiv.

RBK

Gas issue remains in limbo

July 16, 2012

The Yalta meeting of the Heads of Russia and Ukraine, Vladimir Putin and Viktor Yanukovych, left the gas issue pending, although it is currently the most acute problem on the bilateral economic agenda of the two states. Consultations at different levels held by the countries during 2011-2012 bore no results.

As is generally known, Ukraine is dissatisfied with the high prices for gas supplied by Russia's Gazprom and for the third consecutive year the state is trying to cut them down by any means available. Meanwhile, Russia sees the gas agreements as legal support for negotiations with Ukraine on a wide range of issues. For instance, in 2010 Ukraine received a 30% discount on gas in exchange for extending the lease of a naval base to Russia's Black Sea Fleet until 2042.

High gas prices resulted from the so-called "Putin-Timoshenko gas agreements", signed on January 19, 2009 after the 20-day "gas war", during which several European countries suffered from the underdelivery of Russian gas, since Ukraine siphoned off gas intended for Europe for its own needs. Russia and Ukraine then signed ten-year contracts, defining a formula for calculating the gas price for Ukraine, consumption volume, and the gas transit tariff.

Expert

Russia ratifies border control agreement with Ukraine

November 13, 2012

Russian President Vladimir Putin ratified an intergovernmental agreement with Ukraine on cooperation in joint control over people, vehicles and goods on the Russian-Ukrainian state border. The agreement is expected to enhance the effectiveness of checkpoints on the Russian-Ukrainian state border and to simplify the customs procedures. The agreement's provisions establish framework for cooperation in carrying out joint border checks, including checking people and vehicles, detaining those violating the border, carrying and using special

equipment and using service dogs by Russian border officials on Ukraine's territory, and by Ukrainian border officials on Russia's territory. Joint monitoring is carried out on highway and railway border crossing points, and may also be performed on passenger trains between border crossing points.

The agreement was approved by the State Duma on October 19 and by the Federation Council on October 31, 2012.

Expert Online

RUSSIA-KYRGYZSTAN

Russian-Kyrgyz agreement on citizenship annulled

March 21, 2012

The Russian government has reached a decision to renounce an agreement with Kyrgyzstan on simplifying the naturalisation of Kyrgyz citizens in Russia, the head of the Russian Federal Migration Service (FMS) Konstantin Romodanovsky stated.

The agreement mainly duplicates the four-party agreement between Belarus, Kazakhstan, Kyrgyzstan and Russia on a simplified procedure for obtaining citizenship dated February 26, 1999. Under such circumstances, the bilateral agreement lost its relevance for Russia.

Note:

The draft federal law on the renouncement of the agreement between Russia and Kyrgyzstan on a simplified procedure for obtaining citizenship was introduced by Russia's Foreign Ministry and the FMS in early March 2012. The naturalisation agreement came into effect on November 9, 1997. The statistical data shows that from 2004 the number of Kyrgyz nationals obtaining Russian citizenship has been growing steadily. For instance, more than 16,000 Kyrgyz migrants were naturalised in Russia in the first quarter of 2011 (an increase of 85% year on year), while the overall number of Kyrgyz labour migrants who have obtained Russian citizenship since 1997 tops 300,000.

Expert Online

Moscow and Bishkek to revise agreements

April 6, 2012

Russia and Kyrgyzstan are on the brink of a new confrontation. Moscow insists on the revision of a number of key intergovernmental agreements, Russian Foreign Minister Sergei Lavrov said during his recent visit to Bishkek. In the event of Kyrgyzstan's refusal, Russia may reconsider its terms of cooperation on the fuel sector, which is extremely important for Kyrgyzstan.

April 10, 2012

Russia handed over a set of documents to Kyrgyzstan outlining Moscow's proposals for the revision of two key intergovernmental agreements in the hydropower and defence industry signed in 2008-2009. According to the first agreement, Russia acquires a 48% stake in the Dastan Torpedo Factory, producing the VA-111 Shkval (squall) torpedoes, and the premises of the Russian trade mission, in exchange for Kyrgyz debt relief amounting to \$180 million. However, Moscow currently demands a 75% stake at the same price, insisting that Dastan's assets have depreciated since 2009 due to the wear and tear of equipment. Kyrgyzstan strongly disagrees with this viewpoint.

The second agreement stipulates the terms of Russia's participation in the construction of the 1.9 GW Kambarata-1 HPP and the cascade of hydropower plants on the Naryn River. The parties have established a joint Russian-Kyrgyz Kambarata-1 HPP company, with Russia's INTER RAO UES holding a 50% stake. The total construction cost was estimated at \$2 billion. Back in 2008 the parties assumed that Moscow would provide a \$1.7 billion loan for implementing the project. The parties have thus far conducted only design studies on the Kambarata-1 HPP project, while the issue of financing construction has not yet been resolved. Meanwhile, Russia's RusHydro planned to allocate \$400 million for the construction of the Upper Naryn Cascade of four HPPs with a total capacity of 200 MW. Russia and Kyrgyzstan agreed on 50/50 joint ownership of the HPPs; however, Moscow now insists on a 75% stake in the future HPPs as the current terms "do not reflect the actual contributions of the two parties".

Bishkek considers these proposals to be unacceptable. According to Kyrgyz authorities, Russia is trying to tie the resolution of these two issues to the supply of fuels and lubricants on a duty-free basis. At present Russia supplies Kyrgyzstan with about 750,000 tonnes of zero-duty fuel per year (Kyrgyzstan's total demand for fuel stands at 1.2 million tonnes), annually contributing \$240-\$280 million to the country's economy. As it is the start of the spring sowing season, Kyrgyzstan's demand for fuels and lubricants will grow in the short term, and if Russia introduces fees or restricts import of fuels (as was the case in 2010), it could destabilise the situation in the republic.

Kommersant, Vedomosti, Expert Online

Russia and Kyrgyzstan ink several agreements

September 20, 2012

Russia and Kyrgyzstan signed a number of agreements, including the Agreement on the Status and Conditions of the Joint Russian Military Base Presence on

the Territory of the Kyrgyz Republic. According to the agreement, Russia will maintain a joint military base in Kyrgyzstan for another 15 years starting 2017 with a possible prolongation for another five years.

The parties sealed the settlement of Kyrgyzstan's debts. Russia agreed to write off one Kyrgyz debt of \$190 million, while the second one, amounting to \$300 million, will be repaid on eased terms.

Moreover, Russia and Kyrgyzstan inked an intergovernmental agreement on the construction and further use of Kambarata-1 HPP and the Upper Naryn Cascade.

Kommersant-Online

MISCELLANEOUS

Tajiks to work legally in Russia for up to three years

October 5, 2012

Russian President Vladimir Putin and Tajik President Emomali Rakhmon reached an agreement to relax bureaucratic procedures for Tajik migrant labourers seeking to work in Russia. Under the new terms, migrants will be granted work permits valid for up to three years and will also have up to 15 days to register after arriving in Russia. The new agreement will have a positive impact on the labour market in Russia, stabilising the situation with the foreign labour force and will enable the citizens of Tajikistan to form their life plans on a more solid basis.

Expert Online, RIA Novosti

ECONOMIC SECTORS

OIL AND GAS

Talks over Ukraine's GTS yield no results

January 12, 2012

Gazprom head Alexei Miller briefed the President of Russia Dmitry Medvedev on the outcomes of Gazprom's negotiations with Ukraine's Naftogaz on Russian gas prices and the state of the Ukrainian gas transportation system. Gazprom promised Ukraine to half the gas price (to \$210-\$220 per 1,000 m³) in return for control over the country's GTS. However, the situation with gas talks between Russia and Ukraine is clearly at an impasse. Ukraine insists on reducing Russian gas imports by one third (to 27.5 billion m³), values its gas transportation system at \$20 billion (which is double the estimates of Russian experts) and requires that the current gas supply agreement valid until 2019 be revised.

Gazprom is deeply concerned over Ukraine's intention to reduce the volume of gas purchased. In this case the monopoly will require that Ukraine pays for at least 44.2 billion m³ of gas, according to take-or-pay terms set by the contract (85% of the contract volume of 52 billion m³ a year).

Ukraine is already actively reducing its purchases of Russian gas. According to Gazprom, Ukraine purchased 17.9 billion m³ in Q1 2011, 9.4 billion m³ in Q2 2011, and up to 5.1 billion m³ in Q3 2011.

Kommersant

Lossmaking refining

February 24, 2012

Russian-British oil company TNK-BP decided to suspend operations at its Lisichansk refinery in Ukraine. Oil refining in Ukraine has become unprofitable due to increased excise duties and frozen fuel prices in Russia.

The company said it observed a critical situation in the Ukrainian refinery sector for over a year and demanded protective measures from the state, which would help at least preserve the operating oil refineries.

A year ago, TNK-BP was already considering the possibility of shutting down the refinery. Tolling operations allowed the plant to refine 300,000 tonnes of oil every month, with oil products being mainly supplied to the southern regions of Russia. However, tolling operations stopped being attractive in October 2011, as Russia introduced new tax norms, the so-called "60/66 regime", which made the export of oil more profitable than refining. In addition, following an administrative procedure, all upward adjustments of retail fuel prices by Russian oil companies were prohibited until after elections.

Another Russian oil company, LUKoil, suspended its Odessa refinery in October 2010 for scheduled maintenance due to low profitability and the unfavourable situation on the Ukrainian market. Operations at the refinery have not resumed since.

Refining in Ukraine remained an unprofitable business in the first quarter of this year, which had a significant influence on the general financial performance of TNK-BP. TNK-BP had \$68 million losses in Ukraine in 2010; losses continued in 2011.

Expert Online

Ukraine to reorganise Naftogaz

March 20, 2012

The Parliament of Ukraine adopted a draft law providing for the reorganisation of Ukraine's national joint stock company Naftogaz, an energy company entirely

owned and run by the state and which holds and manages the Ukrainian gas transportation system (GTS). The new bill allows Naftogaz to be reorganised but prohibits the privatisation (as well as expropriation, renting, leasing, concession etc.) of GTS and underground storage facilities belonging to both Naftogaz and any companies which may be established as a result of the reorganisation of the group. Control over Naftogaz assets – or assets of its subsidiaries – can only be handed over to other companies fully owned by the Ukrainian state. The reorganisation is subject to prior approval by the Cabinet of Ministers of Ukraine.

The draft may further complicate Russian and Ukrainian gas talks that have been halted and unproductive since late 2011.

At present Ukraine is getting ready for a GTS upgrade. According to the Deputy Chairman of the Naftogaz Board, Vadim Chuprun, the appraiser selection procedure has already begun. The previously estimated cost of GTS modernisation stood at \$5-\$7 billion.

Kommersant, Gazeta.ru

Kazakhstan switches its Southern regions to Turkmen gas

May 14, 2012

Kazakhstan is boosting gas cooperation with Turkmenistan, Kazakh Oil and Gas Minister, Sauat Mynbayev, reported during a government session. According to him, Kazakhstan faces many difficulties while purchasing gas from Uzbekistan. In this regard the parties inked a trilateral agreement on November 9, according to which Kazakhstan will purchase gas from Turkmenistan. As at April 1, 2012, Turkmenistan had supplied 738 billion m³ of gas to Kazakhstan. In line with the agreement, Ashgabad will supply another 300 million m³ of gas and will remain Kazakhstan's general partner in delivering gas to southern regions of the republic over the next several years. KazTransGaz, is currently reviewing the Protocol on Turkmen gas deliveries for during the 2012-2013 heating season, together with Gazprom, China and Turkmenistan, Mynbayev said.

Expert Kazakhstan

Ukraine to diversify its gas supplies away from Russia

May 2, 2012

Ukraine's state-owned Naftogaz oil and gas company signed a framework agreement with Germany's RWE Supply & Trading GmbH (RWEST) concerning gas supplies, according to the press service of Naftogaz. The agreement provides legal grounds for future natural gas supplies from RWEST to Ukraine and does not contain any obligations on compulsory purchases.

Prices and supply volumes, as well as the parties' commitments regarding supplies, are to be determined by separate contracts, which are yet to be negotiated.

Ukraine has been struggling to no avail to obtain a discount for gas from Russia following the 2009 gas deal it signed with Russia's Gazprom. In mid-March 2012, Ukrainian Prime Minister Mykola Azarov announced that Naftogaz was in talks with RWE on providing Ukraine with natural gas by reverse-direction pumping. The intention to launch gas purchasing on the European spot markets this summer was also voiced by the Minister of the Energy and Coal Industry Yuriy Boiko, while Naftogaz's head, Yevhen Bakulin, reported on the ongoing negotiations on purchasing up to 10 billion m³ of gas from Europe.

Experts believe that the gas market, particularly that of the CIS, leaves almost no opportunities to diversify the supplier base. The agreement with RWE is rather a political move than an economic one, given its "framework" nature. The Russian monopoly provides its usual discount to Ukrainian consumers, while such price levels are hardly possible on the part of RWE. Given that the discount to the former Soviet Union states amounted to about 70% in 2011, Gazprom's position remains as steadfast as it was.

Expert Online

Gazprom and Armenia discuss gas delivery expansion

June 29, 2012

Gazprom Chairman, Alexey Miller, and Armenian Energy and Natural Resources Minister, Armen Movsisyan, held a meeting on June 29, 2012, to address issues surrounding bilateral cooperation in the gas sector including progress with the agreement on Gazprom's participation in Armenian gas-fired power generation projects. Special consideration was given to development prospects for the ArmRosGazprom joint venture.

The meeting also paid special attention to the pricing of Russian gas and ramping up its supplies to Armenia in 2012-2013.

Finam.ru

Gazprom to stick to its current gas supply agreement with Ukraine

June 27, 2012

Russian gas giant Gazprom has not agreed to cut term gas supplies to Kyiv in 2013, CEO Alexei Miller said, denying statements to that effect by Ukrainian officials. Earlier, media in both countries quoted Ukraine's energy and coal industry minister Yuriy Boyko as saying that Gazprom and Naftogaz had agreed that the Russian gas supply to Ukraine will be cut to 27 billion m³ in 2013.

Ukraine has sought to cut the volume of its gas imports from the 52 billion m³ envisaged by the current contract to 27 billion m³. In its turn, Russia stated that Ukraine has missed its chance to alter gas purchase volumes for this year as the annual contracted volume has to be changed at least six months before the start of gas supplies, that is, before July 1, 2012.

Expert Online

Rosneft may enter Armenian fuel market

August 13, 2012

Russian Rosneft is seeking ways to expand outside Russia. The company is expected to enter the Armenian retail fuel market, becoming a major supplier of oil products to Armenia, and is likely to create a joint venture with a local oil vendor to build a network of 40–50 petrol stations and a fuelling complex at Armenia's international airport in Yerevan.

The Armenian oil market is estimated at 340,000–360,000 tonnes per year, imported mostly from the Romanian OMV plant via the Georgian port of Poti.

Experts believe that the Armenian market may be of interest to Rosneft, as the company seeks to reach out to new regions and the fuel business remains high-margin. The current increase in the capacity of Rosneft's Tuapse refinery from 4.55 million to 12 million tonnes of oil products would require the company to step up exports. However, Rosneft will first have to work out the best logistic route to Armenia. To date, the route through the Black Sea and the Georgian port of Poti is complicated by political factors; furthermore, there is no opportunity to transit oil products via Azerbaijan, and no bypass railway. However, gas deliveries to Armenia are currently carried out via the pipeline running through Georgia, so it is possible that Rosneft might also choose the Georgian route.

Kommersant

Russia offers gas discount to Moldova in return for cancelling its EU deal

September 13, 2012

Moscow could sell natural gas to Moldova at a lower price if Chisinau denounces its protocol on entering the European Union energy community agreement and repays its debt of \$4.1 billion.

According to Russian Energy Minister Alexander Novak, the price Moldova pays for Russian gas is based on the same formula as for other European consumers. In the first half of 2012 it amounted to \$392 per 1,000 m³. Meanwhile, Moldova is asking for a 30% discount.

Note:

The EU energy community agreement foresees that by January 1, 2015, Moldova will implement the principles of the EU's Third Energy Package, which imposes limits on the ownership of EU pipeline infrastructure by gas suppliers and calls for the structural unbundling of the local monopolist, MoldovaGaz, into three separate production, transportation and supply companies, which is unacceptable to Gazprom, the majority shareholder in MoldovaGaz.

Expert Online

Ukraine fails to bargain Russian gas imports for 2013

October 11, 2012

Ukraine and Russia failed to agree on the volume of gas imports for 2013. The gas price for Ukraine amounted to around \$416 per 1,000 m³ in Q1 2012, \$425 in Q2 2012, \$426 in Q3 2012 and \$432 in Q4 2012, which roughly tallies with the average gas price under Gazprom's foreign contracts (11,526 roubles per 1,000 m³), but is higher than the average for the CIS (8,633 roubles) and far above the Russian average (2,701 roubles) (Gazprom data for Q1 2012).

Kyiv has been struggling to cut down gas prices and gas purchase amounts for more than two years. According to Russian officials, Russia could lower prices to Belarus's level in exchange for Ukraine's accession to the Customs Union. But Kyiv has so far publicly rejected the idea of integration, stating in its turn that the country will halt imports and shift to satisfying its own energy needs if Russia does not lower its prices. By 2020, Ukraine will be able to produce about 45 billion m³ of gas, Minister of Ecology and Natural Resources Eduard Stavitsky reported. According to the IHS CERA forecast, Ukraine's domestic gas production could grow 3.8-fold by 2035 to 70 billion m³ with current consumption of 53.7 billion m³.

Ukraine has already made the first step towards increasing its production capacity and energy potential by inviting global oil and gas players to tender for the development of the Scythian field on the Black Sea shelf. The winning bid was placed by a group of companies, led by ExxonMobil, including Shell, Petrom and Nadra Ukraine (the project's cost is estimated at \$10 billion).

Vedomosti, Expert Online, RIA Novosti

Moscow and Minsk may resume their traditional oil dispute

October 30, 2012

Moscow and Minsk may find themselves debating oil issues once again. Since 2011, Belarus does not pay duties on oil and oil products imported from Russia, but instead is required to transfer to the Russian budget all revenues from export

duties on over-quota petroleum products and crude oil (1.7 million tonnes). However, no export duty is levied on solvents and lubricants, the production of which is booming in Belarus. According to the National Statistics Committee of Belarus (Belstat), export of solvents in 2011 increased almost 9-fold to 2.1 million tonnes from 0.24 million tonnes in 2010, while in January-July 2012 it grew to 3.24 million tonnes. Russian authorities voiced suspicions over Belstat data. First of all, prior to 2011, the global export market of solvents and thinners amounted to only 1.5 million tonnes. Moreover, Latvian ports, which, according to Belstat, received 1.5 million tonnes of solvents in 2011, reported on transshipment of only 0.2 million tonnes, while fuel shipments increased by 2.5 million tonnes compared to 2010. Finally, Belarus failed to supply the contracted amount of fuel to Russia. Under the agreement with Moscow, Minsk is to supply 5.8 million tonnes of high-quality oil products, but, according to the Russian Ministry of Energy, by August 2012, Russia had received only 112,000 tonnes, or 1.9%.

According to the agreement, Belarus may receive 21.5 million tonnes of duty-free crude this year, as Russian oil majors see no economic benefits in cutting supplies of duty-free crude to Belarus. The companies supplying crude to Belarus include Rosneft (4 million tonnes), LUKoil (4 million tonnes), Surgutneftegaz (3.5 million tonnes), Slavneft (3 million tonnes), and TNK-BP (2 million tonnes). In addition, Russian companies are interested in acquiring stakes in Belarusian refineries. Slavneft (owned on a par by TNK-BP and Gazprom Neft) has already purchased over 40% of the Mozyr refinery.

Vedomosti

Belarus may face new round of economic crisis

November 19, 2012

Industrial production in Belarus is decelerating. While in January-July 2012 industrial production increased by 8.6% year on year, in January-October 2012 it grew only by 6.6%. According to Belarusian economists, the slowdown results from a cutback in oil deliveries from Russia (by 26% in October) and the termination of supplies of oil products from Belarus to Europe under disguise of solvents and thinners without paying duties to Russia. Russia's estimated losses caused by the Belarusian smuggling scheme amount to \$1.5-\$2.5 billion, which is equal to almost 20-35% of Minsk's financial reserves.

The halt of solvent exports had an immediate impact on the foreign trade balance of Belarus. The surplus turned into deficit in the short term, raising concerns over the economic prospects and the local currency exchange rate. The termination of the "solvent scheme" coincided with the recession in global demand for potash fertilisers, one of the topmost items of Belarusian export. In January-August 2012, Belarusian exports fell by 9.5% in value terms due to

lower fertiliser prices. Exports of Belarusian tractors, trucks and refrigerators are not enough to offset the raw material export slump.

Expert Kazakhstan

Gazprom to increase gas transit via Belarus

November 22, 2012

Following the results of the working meeting with the President of Belarus, Alexander Lukashenko, head of the Russian gas giant Gazprom Alexey Miller announced an increase in gas supplies to Belarus this year by 10% to 22 billion m³. Moreover, Gazprom will consider the possibility of increasing Russian gas transit to Europe via Belarus by 30% (around 15 billion m³ per year).

Starting in 2013, Gazprom plans to invest \$2 billion in upgrading booster stations and the linear gas pipeline portion, making it possible to significantly boost gas transit in the next three to four years.

According to Miller, this year's level of transit will be about 44.5 billion m³, which at present is the maximum possible load.

Thus, Belarus is gradually taking over Ukraine's transit role. Gazprom has long been striving to gain control over the Ukrainian gas transportation system within the framework of a bilateral cooperation agreement. However, Kyiv is so far interested in establishing a tripartite consortium with the participation of the EU. From the beginning of 2012, Ukraine is trying to negotiate a revision of gas prices and a reduction in the volume of gas imports with Gazprom; however, the parties have not yet reached an agreement.

RBK Daily

Gazprom clinches deal to buy Uzbek gas

December 24, 2012

Russian energy giant Gazprom and Uzbekistan's state oil and gas company Uzbekneftegaz signed a contract to buy Uzbek gas and an agreement on gas transit through Uzbekistan for 2013-2015. Moreover, the parties agreed to set up a joint working group for elaborating a new long-term strategic cooperation agreement between Gazprom and Uzbekneftegaz.

The volume of planned purchases was not disclosed. Central Asia and the South Caucasus form an important part of Gazprom's overall resource base. Thus, Russia purchased 13.9 billion m³ of Uzbek gas in 2010 and 33.3 billion m³ of Central Asian and Azeri gas in 2011.

Signed on December 17, 2002, the agreement on strategic cooperation in the gas sector between Uzbekneftegaz and Gazprom provides for long-term purchases of Uzbek gas for 2003-2012. The agreement also determines

Gazprom's participation in natural gas production projects in Uzbekistan under the production sharing agreement, as well as cooperation in developing Uzbekistan's gas transportation infrastructure and transiting Central Asian gas through the republic. Within the framework of the strategic cooperation agreement the parties have inked several contracts on gas purchases and transit, which expire on December 31, 2012.

In 2011, China voiced its plans to increase gas imports from Central Asia fivefold by 2015. The capacity of the Central Asia-China gas pipeline, built in 2009, currently amounts to 40 billion m³ and is expected to increase to 55-60 billion m³ of gas per annum in the coming years.

RBK

Russia ratifies gas agreements with Belarus

December 31, 2012

The President of Russia, Vladimir Putin, signed a law on ratification of two intergovernmental gas agreements with Belarus, including an agreement on the terms of purchase and sale of shares and further activities of OJSC Beltransgaz, and the Russia-Belarus agreement on setting prices (rates) for natural gas supplies to Belarus and gas transit via Belarusian pipelines. Both agreements were ratified by Russia's State Duma.

The agreement sets gas prices for Belarus for 2012 and defines the pricing formula for 2013 and subsequent years, tying it to the price of gas for consumers in Russia's Yamalo-Nenets Autonomous District, and sets the rules for tariff calculation for natural gas transportation and transit by Belarusian pipeline operator Beltransgaz for foreign and domestic consumers.

Gazprom gained control over Beltransgaz through two acquisitions of 50% of shares for \$2.5 billion each. In accordance with the supply contract approved by Gazprom shareholders, Beltransgaz may purchase up to 69 billion m³ of gas in 2012-2014 for a total amount of \$17.25 billion. Under the agreements, Beltransgaz will transit up to 60 billion m³ of Russian gas in 2013, up 34.8% from 2012.

Vedomosti, Interfax

ENERGY

Russia and Kazakhstan to revive power bridge project

April 12, 2012

En+ Group launched coordination of a project that will make it possible to increase the current flows between the power systems of Siberia, Kazakhstan and Urals from the present-day 1.7 GW to 5 GW.

The power bridge is based on an existing Soviet project developed in 1980 to transfer cheap power from Siberian power plants (including the Angara-Yenisei cascade and coal-fired power plants of the Kansk-Achinsk coal basin) to the Urals.

The power bridge is needed to increase the crossflows between the power systems of Siberia (an energy surplus region with cheap electricity) and central Russia. Moreover, the power bridge could help using a potential of the Kansk-Achinsk and Ekibastuz coal basins. Currently the share of gas in the fuel balance of power plants in the European part of Russia is 85% and an increase in coal share in the fuel balance would free up Gazprom resources to deliver to foreign markets. Gas savings could amount to 15 billion m³ a year. Moreover, it would also be possible to reduce the transportation of fossil fuel to power plants of the Urals and the European part of Russia.

For now, En+ has expressed the greatest interest in the project, and has submitted a draft technical design assignment to the Energy Ministry for a preliminary feasibility study of the power bridge, developed in cooperation with the SetStroyService State Corporation. En+ interest may be explained by several factors. Within the scope of a joint enterprise with Chinese Yangtze Power, Yevrosibenergo is planning to introduce up to 10 GW of new capacity in Siberia. The companies intend to sell the peak power to China, and they could also send power along the power bridge to the European part of Russia, where prices are higher. Moreover, Rusal (controlled by En+) owns a 50% stake in the Bogatyr Komir coal mine, which is developing 8 of the 12 sections of the Ekibastuz deposit.

It is still unclear who will pay for the project, which is worth 36-42 million roubles per kilometre of power transmission lines or for its feasibility study. En+ proposes three financing options, including R&D work by the Energy Ministry or the Security Council, an investment programme by the Federal Grid Company (FGS UES), or the FGS UES investment programme plus co-financing by the stakeholders (with subsequent separation of the power bridge into a separate company with shares distributed proportionally to the feasibility study financing contributions of the stakeholders). According to experts, at the initial stage the power bridge may serve as a physical basis for forming the Eurasian Interstate Wholesale Electrical Power Market within the framework of the Single Economic Space.

Kommersant

Russia to finance NPP construction in Belarus

June 1, 2012

The head of Russia's state-owned nuclear energy corporation Rosatom, Sergey Kiriienko, said that Moscow would allocate \$204 million to finance the first

stage of construction of a nuclear power plant (NPP) in Belarus. According to him, the finance ministries of the two countries have harmonised all the necessary issues. Moreover, the parties have signed a contract for the design and the preparatory work on the site, and approved the first tranche. Moscow will allocate a total of \$285 million to Minsk within the framework of the contract.

The plant will be built by Russia's Atomstroyexport, a Rosatom subsidiary. The NPP under the AES-2006 design will consist of two reactors with a capacity of 1,200 MW each and will boost the entire Belarusian energy system's capacity to 8,000 MW. The power plant's first unit is due to be commissioned in 2017 and the second in 2018.

June 22, 2012

First Deputy Prime Minister of Belarus, Vladimir Semashko, informed that Belarus and Russia plan to sign a master contract to construct the first NPP in the country in July. According to Semashko, the agreement is currently being finalised, while the preparatory works at the NPP construction site in Ostrovets, Grodno Region have already begun with roads and railways already in place. Semashko noted that the NPP's first unit will be commissioned within 60 months after the launch of construction, while construction of the second power unit will take another 78 months. Belarus will be responsible for about 50% of all construction and assembly works and 25% of the peripheral equipment supplies.

Note:

Russia and Belarus inked the intergovernmental agreement on the NPP construction on March 15, 2011 in Minsk.

July 19, 2012

Russia's Prime Minister, Dmitry Medvedev, visited Minsk to sign the master contract for the construction of the first Belarusian NPP.

Expert Online

Ukraine to launch electricity supplies to Russia

July 19, 2012

DTEK, Ukraine's largest private energy holding, signed a framework agreement with Russia's INTER RAO UES for electricity supplies to Russia. Under the agreement DTEK will launch cross-border power supplies via the interstate power transmission lines between the Ukrainian and Russian grids to provide the best power plant load ratio for both countries.

In autumn 2011, after a two-year break, DTEK resumed power deliveries to Poland and Moldova. As a result, DTEK electricity exports grew by 805.9 million kWh to 1.812 billion kWh in Q1 2012. Moreover, DTEK supplies electric energy to Belarus, Slovakia, Hungary and Romania. Deliveries to Europe increased by 389 million kWh in Q1 2012 year on year.

In early July 2012, DTEK made its first coal acquisitions in Russia by closing a deal with Rostovsky Anthracite LLC, to buy three mines and a coal processing plant in Rostov region.

The commercial reserves of the mines are estimated at 136 million tonnes. The companies mined nearly 0.5 million tonnes of coal in 2011; however, DTEK plans to increase output to 2 million tonnes per year.

The acquisition of the companies in Rostov region will expand DTEK's resource base and improve the quality of the coal supplied to Ukrainian thermal power plants (TPPs), helping to prevent fuel shortages in winter.

Note:

DTEK is the largest privately-owned vertically-integrated energy company in Ukraine, part of System Capital Management (SCM) financial and industrial group.

RBK

RusHydro launches HPP construction in Kyrgyzstan

October 29, 2012

Russia's hydropower giant RusHydro has confirmed its plans to launch construction in spring 2013 of four hydropower plants (HPPs) that will form the Upper Naryn cascade on the Naryn River in Kyrgyzstan.

The four HPPs will have a combined capacity of 191 MW when complete and an average annual output of over 1 billion kWh. The whole cascade is set to be commissioned by 2017.

To complete the project, RusHydro will set up a 50/50 joint venture with Electric Stations JSC, Kyrgyzstan's electric energy generation monopolist.

The cost of the project is estimated at \$410-\$425 million. The project's financing scheme and the terms of RusHydro's involvement in the project will be determined after running feasibility studies. However, according to the existing arrangements, the funds will be allocated from Russia's budget in exchange for strategic and operational management of the project for the whole payback period.

The joint venture is currently set to announce a tender for the project's feasibility studies.

Therefore, successful and timely implementation of the project will provide Russia and Kyrgyzstan with an option to build another eight small HPPS in the upper reach of the Naryn River after 2017 and on the condition of efficient construction of Kambarata-1 HPP in the middle reach of the Naryn River. The \$2.5-billion power plant with estimated capacity of 875 MW is being built on a 50/50 basis by Electric Stations JSC and INTER RAO.

Expert Online

Rosatom transfers nuclear fuel production closer to reactors

November 8, 2012

Rosatom intends to transfer most of its nuclear fuel production from the Novosibirsk Chemical Concentrates Plant (NCCP, TVEL subsidiary) to Ukraine's Smolino in Kirovograd region. By late 2015, Nuclear Fuel Production Plant PJSC – a joint venture of the Ukrainian state-run Nuclear Fuel group of companies (51%) and Rosatom's TVEL Fuel Company (49%) – will launch its first line.

The shareholders are to commit \$120 million in equal shares to the plant's authorised capital, with \$20 million to be invested by late 2012.

The Ukrainian plant's production capacity is estimated at 800 TVSA (fuel clusters) per year with 377 staff members engaged in production.

TVEL is the only producer of nuclear fuel in Russia, accounting for 17% of the global market. In addition to NCCP, nuclear fuel is produced at Elektrostal Machine Building Plant near Moscow. About half of the nuclear fuel produced at the Novosibirsk plant is supplied to Ukrainian NPPs.

To compensate losses, Siberia is currently designing and launching alternate production. Thus, NCCP plans to launch production in 2014 of cathode materials for lithium-ion batteries at its subsidiary, Cathode Materials (on NCCP's grounds), with capacity of 3,500 tonnes per year and investment of 5 billion roubles. Moreover, in late 2011, NCCP mastered production of uranium-aluminum targets for radiation medicine, the majority of which are supplied to the Research Institute of Atomic Reactors (Ulyanovsk region).

Vedomosti, Expert Online, RIA Novosti

AUTO INDUSTRY

AvtoVAZ to launch car production in Kazakhstan

June 8, 2012

Russia's largest automakers, AvtoVAZ and Sollers, plan to produce vehicles jointly in Kazakhstan, according to Russian President Vladimir Putin.

In November 2011, AvtoVAZ signed a memorandum on strategic cooperation with Kazakhstan's ASIA AUTO car assembly plant and Yertys Social and Entrepreneurial Corporation to build a \$500 million assembly plant in East Kazakhstan with a capacity of 120,000 cars per year.

The primary manufacturing base for the project will be provided by ASIA AUTO, which has been assembling four Škoda models, five Chevrolet models, seven KIA models and, of course, the Togliatti Niva in Ust-Kamenogorsk for the last ten years. However, production is based mostly on the semi-knocked-down assembly method, while Kazakhstan is looking for the establishment of a full-cycle car production. Thus, the Russian-Kazakh joint venture will focus on opening a Lada car factory, including welding, colouring and assembly lines, and the production of components. The first assembly line producing 90,000 cars per year is due to be completed in 2015, and the second line for 30,000 cars per year in 2017. The Kazakh-assembled cars will be sold in Central Asia, the Caucasus, Siberia and the Far East region of Russia.

By launching the plant in Kazakhstan, AvtoVAZ is obviously trying to gain a foothold in the southern car market and to go some way to offset the weakening of demand outside the western border of Russia. In 2011, AvtoVAZ dominated the Ukrainian market, but in the first quarter of 2012 the leadership went to the Korean concern Hyundai. Sales of Lada cars in Ukraine in this period fell by 42% compared with the first quarter of 2011, to 3.8 million vehicles, while AvtoVAZ's share in the Ukrainian market contracted from 16.2% to 8.7%.

Expert Online

Bogdan is moving to Nizhny Novgorod

July 18, 2012

Ukraine's Bogdan Corporation has decided to revive its project for producing cars in Russia, the representative of the automaker said. United Transport Technologies, a joint venture between Bogdan and Ukravto established before the crisis, had plans to build a car plant in Nizhny Novgorod region with a capacity of up to 240,000 cars and buses a year (in particular, the parties planned to produce Chevrolet) and to launch engine production with estimated investments of \$770 million. However, the project was shelved due to the 2008 crisis.

Ukravto withdrew from the project in 2008, and now Bogdan is looking for new partners. In particular, the company is in talks with several European manufacturers and is considering various forms of future cooperation, including joint venture and contract manufacturing.

Bogdan owns two manufacturing facilities, one in Lutsk, where it produces buses and trolleybuses (capacity of up to 9,000 units per year), and a second one in

Cherkassy for motor car production (capacity 150,000 units). The equipment from the Cherkassy plant could be transferred to Nizhny Novgorod to set up a full production cycle.

The Ukrainian car market contracted and demand slumped, resulting in only 10-15% load at local plants which are capable of producing a total of about 400,000 cars a year (according to the ASM-Holding, Bogdan produced 6,898 cars in January-May 2012).

To secure the load of its Ukrainian plants Bogdan is, inter alia, trying to negotiate the production of approximately 60,000 Lada Granta a year with AvtoVAZ. Negotiations are in progress, but decisions on timing and production volumes are still pending, the representative of AvtoVAZ said.

Vedomosti

KamAZ and MAZ merger agreed

August 31, 2012

After a year and a half of negotiations, Russian Technologies state corporation and the Belarusian authorities reached agreements on the key parameters for integrating the KamAZ and MAZ automakers. Under the deal KamAZ and MAZ will merge in a holding company, Rosbelavto. Russia and Belarus will contribute 49.9% of KamAZ and 75% of MAZ stock to the joint venture, respectively, and gain equal shares in the company. The transaction terms allow Russian Technologies to buy an additional 25% of shares in the JV within two years.

The idea of consolidating KamAZ and MAZ in one company was first put forward by Russian Technologies in February 2011. Initially, the parties planned to exchange shares of KamAZ and MAZ, but later decided to establish Rosbelavto JV. Belarus insisted that both KamAZ and MAZ each contribute 49.9% of their stock to the JV. Moreover, Belarusian authorities demanded that Ernst&Young revise its appraisal of MAZ assets on the grounds that it was understated (the international auditor estimated MAZ at \$800 million). In spring 2012, Ernst & Young reevaluated the companies' assets and estimated the cost of MAZ assets at \$1.1 billion, with KamAZ assets evaluated at \$1.6 billion.

It was initially obvious that to establish a parity joint venture would require a larger share of MAZ than KamAZ. The Belarusian authorities insisted on par but were not willing to turn control over to Russia, so to reach a consensus the parties agreed on a gradual transfer of control. As a result, Belarus will retain a blocking share, which will allow control over Rosbelavto's decisions in the future. Experts believe that Belarus may sell its blocking stake in MAZ in years to come. In 2011, Minsk already considered the possibility of its sale to GAZ Group.

Kommersant

SPACE AND AVIATION

Russia, Kazakhstan in deadlock over rocket launches

May 28, 2012

Kazakhstan's space agency Kazcosmos is blocking three Russian Soyuz satellite launches over a dispute over the drop zone for debris. The problem stems from the use of the N120 drop zone, which Kazcosmos argues would require an additional agreement to the current lease.

The impasse means that Europe's MetOp-B meteorological satellite, previously scheduled on a May 23 flight at Baikonur spaceport, remains grounded, while two future launches, one on June 7 involving Belarusian, Canadian, German and two Russian satellites, and one in August of the Russian satellite Resurs-P, have been postponed indefinitely.

The first stages of the Soyuz rockets that were scheduled to launch a total of seven satellites were due to fall to earth over an area in the Kostanay and Aktobe regions of North Kazakhstan, which is only occasionally used as a drop zone for debris. Kazakhstan insists that the two sides must sign an additional intergovernmental agreement to specify the terms of use of the drop zone and the extra cost that Russia will have to pay. Russia argues that the drop areas are located in the restricted zone and that Kazakhstan's requirement is in fact a mere add-on to the annual Baikonur lease even though Roscosmos is currently implementing the Baikonur upgrade programme: repair work has already begun on the 39th launch unit, while modernisation of the 31st launch pad area is due to be completed by the end of 2012. Given the importance of commercial launches, Russia finally agreed to negotiate a treaty over acceptable drop zones.

Under the Baikonur lease agreement, which is due to last until 2050, Russia pays Kazakhstan almost \$115 million in rent annually.

Kommersant

Russia is ready to build AN-70 aircraft together with Ukraine

May 28, 2012

Russia's President Vladimir Putin and Prime Minister Dmitry Medvedev met with the Prime Minister of Ukraine Nikolai Azarov on May 26-27. The parties discussed joint projects in high-tech industries, including production of the AN-70 military transport aircraft.

Antonov's airplanes are famous for their ruggedness and reliability. For instance, the AN-24 (AN-26) is an essential close-range aircraft in the Far North, Siberia and the Far East. However, both Russia and Ukraine failed to establish full-

fledged production of the AN-24's successor – AN-140, or to revive production of the AN-124 Ruslan, the world's largest heavy-lift transport aircraft. The AN-148 close-range passenger aircraft for 85 seats, manufactured by Russia's United Aircraft Corporation (UAC) since mid-2009 by Voronezh Aircraft Manufacturing Company (VASO) under Antonov's licence, has not enjoyed large sales in Russia.

According to the Russian military, the AN-70 is to replace the AN-12 mid-range military transport aircraft in the Russian armed forces. In February 2012, the AN-70's cost was estimated at \$67 million. Given the scant demand for the AN-70 from the Ukrainian Air Forces (5 aircrafts), the parties considered the possibility of producing the aircraft in Russia. Under the preliminary agreements, Ukraine will manufacture the aircraft's wings and engine and supply them to Russia (Ukrainian Motor Sich JSC is the sole producer of the D-27 engine for the AN-70), while the Russian company will manufacture the airframe and fuselage, and carry out the aircraft's final assembly.

The parties are currently at odds over choosing the manufacturing base for the airframe production and aircraft assembly. UAC and Antonov have decided on VASO, while the leadership of Motor Sich believes that production of the AN-70 should be launched at the Ulyanovsk Aviastar-SP or the Gorbunov Kazan Aircraft Production Association.

Expert Online

Baikonur launches resumed

June 15, 2012

Kazakhstan has granted Russia a permit to resume spacecraft launches from the Baikonur spaceport, according to Kazakhstan's Prime Minister, Karim Masimov.

In early June the head of Roscosmos (the Russian federal space agency), Vladimir Popovkin, stated that Russia would carry out within a month the launches of seven satellites that had been previously deferred.

The majority of Russia's state and commercial space launches are made from the Baikonur spaceport, which is leased from Kazakhstan for \$115 million a year. Another \$50 million a year is allocated for maintenance of the spaceport's facilities. According to intergovernmental agreements, Baikonur's lease term ends in 2050. It is expected that Russia will gradually transfer launches under the government programme to sites within its borders, such as the active Plesetsk spaceport, and later to the newly built Vostochny spaceport.

RBK, Expert Online

Baikonur may be transferred under Kazakhstan's jurisdiction

December 10, 2012

The head of Kazcosmos (Kazakhstan's national space agency), Talgat Musabayev, told reporters that Kazakhstan and Russia are considering an opportunity to transfer Baikonur spaceport to be under the jurisdiction of Kazakhstan. According to him, the governments of both states have decided to set up a new intergovernmental commission on the Baikonur spaceport, chaired by first or other deputy prime ministers of Russia and Kazakhstan. Musabayev assumed that the new commission would be headed by Kazakh Deputy Prime Minister Kairat Kelimbetov and Russian First Deputy Prime Minister Igor Shuvalov.

Baikonur's lease agreement provides for the establishment of a commission tasked to develop a legal framework for the functioning of the leased spaceport. In 1997, the commission's status was altered and all issues were transferred to the control of the intergovernmental commission's subcommittee on cooperation between Kazakhstan and Russia.

Expert Online

FINANCE

Sberbank of Russia clinches deal with ENRC

March 5, 2012

Sberbank of Russia, with the organisational support of its Kazakh subsidiary, signed a \$2 billion loan agreement with the Eurasian Natural Resources Corporation plc (ENRC). The credit facility is one of the most noticeable events of early 2012 on the financial market since it is ENRC's first loan from the largest Russian bank and the largest facility ever provided by a financial institution in Kazakhstan. Until now, the ENRC group has raised financing through loans under international agreements and on the international markets. The loan has been granted for a term of 5 years; other details of the transaction have not been disclosed.

Note:

In 2010, ENRC entered into a \$400 million loan agreement with the Development Bank of Kazakhstan, which was financed by a loan from the state Exim Bank of China. The loan was granted for 15 years with an annual interest rate of 4%. At the same time, Samruk Kazyna National Welfare Fund extended a credit facility to ENRC of \$500 million at 7.5% for 10 years. In February 2011, the presidents of Kazakhstan and China, Nursultan Nazarbayev and Hu Jintao, signed an agreement for a \$2 billion loan facility from China Development Bank for the development of ENRC assets, namely the Sokolovsk-Sarbaisk mining and processing plant and Kazchrome. According to experts, the ENRC global investment programme is estimated at \$12 billion.

Sberbank of Russia is the largest bank in Russia, Central and Eastern Europe, accounting for around 27% of aggregate Russian banking assets.

ENRC is one of the leading diversified natural resource groups with integrated mining, processing, energy, logistical and marketing operations. ENRC operates in the CIS and in China, Brazil and Africa. The Group's assets in Kazakhstan comprise: Kazchrome, Zhairam mining and processing complex, the Sokolovsk-Sarbaisk mining and processing plant, Aluminium of Kazakhstan, Kazakhstan Aluminium Smelter, Eurasian Energy Corporation and ENRC Logistics.

Expert Kazakhstan

Personal remittances from Russia to CIS grow 24% in 2011

May 22, 2012

In 2011, personal money transfers from Russia to the CIS member states increased by about 24% year on year from \$13.5 billion in 2010 to \$16.7 billion.

Personal remittances represent household income transferred from abroad by family members or non-resident households and are usually associated with temporary or permanent migration. Transfers can be made through banks, post offices and money transfer systems, as well as cash and valuables handed over in person.

The main recipients of remittances from Russia in 2011 were Uzbekistan (\$4.9 billion, up 28%), Ukraine (\$3.1 billion, up 25.5%) and Tajikistan (\$2.7 billion, up 26%). Personal remittances to Kyrgyzstan made up \$1.4 billion, while \$1.6 billion was sent to Moldova, \$1.2 billion to Armenia, \$955 million to Azerbaijan, \$458 million to Belarus, \$290 million to Kazakhstan and \$22 million to Turkmenistan.

Expert Online, RIA Novosti, CBR

TRANSPORT AND LOGISTICS

Kazakhstan proposes cooperation with RZD Logistics

February 13, 2012

In addition to its partnership with TransContainer, Kazakhstan Temir Zholy (KTZh) is ready to cooperate with another subsidiary of Russian Railways (RZD) – RZD Logistics (RZDL) – in a project to establish a common logistics operator on an equal footing. However, RZDL has not yet confirmed its participation.

According to experts, initial investment in the joint venture may amount to \$25-\$30 million. The creation of a unified operator will reduce the cost of rail

transportation between the two countries within the framework of the CU and simplify customs clearance procedures. Moreover, it will help reduce tariffs and offer customers the cheapest service, through the ability to operate neighbouring states' rolling stock.

Russian experts believe that this type of cooperation would benefit the development of Russia's Trans-Siberian Railway and the Western Europe-Western China transport corridor that is being developed by Kazakhstan.

Note:

In May 2009, KTZh, Kazakhstan's state-owned railway company, and RZD signed a memorandum on cooperation on terminal handling of cargoes. At the same time the parties agreed to buy JSC KedenTransService, a leading private cargo handling operator in Kazakhstan, in order to increase transit traffic on the railway lines connecting Europe and Asia. In early 2011, TransContainer, an RZD subsidiary and Russian intermodal freight operator, acquired a 67% stake in KedenTransService, while KazTransService, a KTZh subsidiary, bought the remaining 33%. This year KazTransService plans to buy another 17% of shares.

RBK Daily

Russia, Belarus, Kazakhstan to set up container operator

June 25, 2012

Russia, Belarus and Kazakhstan have announced their intention to create a joint railway container operator. The set up of the operator is estimated at \$2 billion and each state is expected to contribute assets to the new venture. RZD will transfer its holding in TransContainer (50% plus one share), while KTZh will contribute its shares in KedenTransService and KazTransService, both engaged in container transportation. Belarus will also participate with its Belintertrans transport logistic centre (a subsidiary of the Belarusian Railway) and terminals in Brest. Thus, each of the shareholders will have a 33.3% stake in the joint venture.

August 17, 2012

The working group for creation of a united logistic operator belonging to Russia, Kazakhstan and Belarus is holding negotiations with Latvijas dzelzceļi (Latvian Railways) about its participation in the joint venture. The operator of the container stations of Latvijas dzelzceļi and terminals in the Riga port may be given as assets to the JV, allowing creation of a real through service of transit cargo transportation between Europe and Asia.

The conditions of Latvian Railways' participation in the joint venture have not been disclosed. Latvijas dzelzceļi is not the first foreign company to receive an

offer to participate in the joint venture. RZD is considering bringing in Deutsche Bahn and China's COSCO Holding as partners.

Expert, Vedomosti

COMMUNICATION

Nationalisation à la Uzbek: MTS troubles in Uzbekistan

MTS is haunted by misfortune in Central Asia. In December 2005, it lost 51% of Bitel, Kyrgyzstan's largest mobile operator, and in late 2010 the Ministry of Communications of Turkmenistan suspended the licence of a local MTS subsidiary, forcing the company to leave 2.4 million subscribers without service. The country's other operators were also forced to terminate their inter-operator contracts with the company. MTS wrote off \$138 million from operating profit in Turkmenistan. The company managed to negotiate the resumption of its operations only in May 2012. At present, MTS's wholly owned subsidiary in Uzbekistan, Uzdunrobita, is facing tax charges from the country's authorities.

Thus, on August 3, 2012, the Prosecutor's General Office of Uzbekistan voiced new claims against Uzdunrobita, MTS's wholly owned subsidiary in Uzbekistan. The Prosecutor's General Office is preparing to bring charges of "engaging in activity without a licence" and "illegal activities of branches without individual licences" against Uzdunrobita. Overall, the amount of claims against Uzdunrobita with regards to alleged failure to comply with the licensing requirements amount to approximately \$220 million. In addition, the investigators state that illegal earnings of Uzdunrobita branches are estimated at \$161 million.

August 9, 2012

New charges were brought against Uzdunrobita by the Uzbek antimonopoly authorities. On August 6-7, 16 regional antimonopoly departments of the Republic of Uzbekistan simultaneously held hearings and declared that Uzdunrobita violated antimonopoly laws, consumer protection laws and laws governing advertisements. In total, the claims of the antimonopoly regulator against Uzdunrobita amount to over \$80 million.

August 13, 2012

The Tashkent Commercial Court upheld the petition of the State Agency for Communications and Information of Uzbekistan to withdraw all Uzdunrobita's operating licences. MTS also announced that it received 16 certificates of inspection conducted by Uzbek tax authorities that have resulted in a total amount of claims against the Company in excess of \$900 million.

August 21, 2012

Reporting its second-quarter results, MTS plans to write off the \$1 billion value of its Uzbek subsidiary, Uzdunrobita, in connection with the withdrawal of its Uzbek operating licence following the Tashkent Commercial Court ruling dated August 13, 2012.

Vedomosti

September 18, 2012

The Tashkent Criminal Court has issued a ruling in favour of the Uzbek state to confiscate all assets of Uzdunrobita, MTS's wholly-owned subsidiary with an annual turnover of \$441 million. Uzdunrobita was denied the right to defend its rights and legitimate interests and to engage as a legal party. MTS reserves the right to use all legal options, primarily in the international arena, and initiate proceedings against officials to claim damages incurred as a result of an unwarranted attack on its subsidiary in Uzbekistan.

Vedomosti

November 9, 2012

MTS announced that the Appeals Court of the Tashkent City Criminal Court has granted the appeal of Uzdunrobita to challenge a decision, dated September 17, 2012, by the Tashkent City Criminal Court, which ruled to confiscate all assets of Uzdunrobita.

However, the court determined that the total amount of fines and penalties to be paid by Uzdunrobita to be approximately \$600 million (equivalent to the company's assets in money terms). The Appeals court also ruled to bring in Uzdunrobita as a civil defendant in the criminal case against MTS Uzbekistan's employees.

The company hopes to negotiate a reduction of its penalties. The ruling of the Appeals Court of the Tashkent City Criminal Court is "the first step taken by the regulator and the company towards each other". MTS will try to recover its licence in the short term in order to resume its work on the "most densely populated" Central Asian market.

MTS is not the first Russian company to face difficulties in Uzbekistan. In 2010, an Uzbek court ordered the nationalisation of the local business of juice and dairy firm Wimm-Bill-Dann. The prosecutor's office brought charges against the company's senior managers for violating tax and customs legislation and rules of trade, as well as for production of commodities of inferior quality, embezzlement, and deliberate failure to fulfill its investment obligations. Three months later, the company was nationalised and its management pardoned.

Vedomosti

MTS resumes operations in Turkmenistan

July 27, 2012

MTS announced that it is resuming operations in Turkmenistan. MTS said that its subsidiary in Turkmenistan, Barash Communications Technologies Inc. (BCTI), had been granted GSM and 3G licences for a three-year term. Under a new five-year agreement with the state telecoms provider, TurkmenTelecom, MTS will pay 30% of its net profit generated in the country on a monthly basis. A similar arrangement existed in the previous agreement as well, although it involved the mobile operator paying only 20% of its net income. On July 25, 2012, MTS, its wholly owned Turkmen subsidiary BCTI, the Sovereign State of Turkmenistan, the Communications Ministry of Turkmenistan, and state-owned operators Altyn Asyr and TurkmenTelecom signed a settlement agreement pursuant to which the parties undertake to withdraw all mutual legal claims pertaining to the cessation of MTS's activities in Turkmenistan. In December 2010, the Turkmen Communications Ministry revoked BCTI's licence after the Turkmen authorities refused to prolong the trilateral agreement. MTS wrote off \$137.8 million from operating profit in Turkmenistan and filed several lawsuits over the case in the International Court of Arbitration of the International Chamber of Commerce in Geneva and in the Arbitration Court of Turkmenistan, while AFK Sistema, MTS majority shareholder, held talks with the Turkmen government to try to settle the case.

MTS will resume its operations before the end of Q3 2012. MTS's infrastructure remains fully in place and MTS Turkmenistan is currently working with vendors to restore the network's capacity and to quickly relaunch services to its subscriber base of more than 2.4 million customers.

Experts believe that the company's return to Turkmenistan is unlikely to have any major impact on the company's value, since even in 2010 when MTS was operating in Turkmenistan, revenues in this country accounted for only about 1.8%.

Vedomosti

SOCIAL SECTOR

Belarus masters labour migration to Russia

May 24, 2012

Belarus is actively using labour migration to Russia as a new way of mitigating the crisis.

According to the Central Bank of Russia, personal remittances from Russia to Belarus accounted for \$458 million in 2011. In this Belarus is still far behind

Uzbekistan (\$4.9 billion), Ukraine (\$3.1 billion) and Tajikistan (\$2.9 billion); however, it is worth taking into account that Belarus is not accustomed to labour migration, given the country's population of under 10 million with employable population hardly reaching 5 million people. According to the current Belstat data, only 4.563 million people were employed in the country in Q1 2012, or 0.1 million less than two months before. The official number of unemployed decreased by 31,000 people.

Belarusian authorities admit that the largest outflows of the labour force are registered in construction (17,932 people recruited and 27,410 fired in Q1 2012), industry (44,571 people hired and 47,596 axed) and education (13,723 people hired and 16,331 dismissed). Moreover, the Belarusian Foreign Ministry acknowledges inevitable future growth in the number of emigrants from Belarus.

In addition, migrants from other countries tend to choose a destination other than Belarus. Thus, in January–May 2012, migration inflow decreased by 55.3% to 1,250 people year on year.

Expert Online

Language bill prompts clashes in Ukraine

June 6, 2012

Ukraine's parliament approved a law in a preliminary reading that will allow the use of Russian as a second official language in nearly half the country. If passed, the law would change the status of Russian in 13 of Ukraine's 27 administrative regions. The bill authorises local governments to grant the status of "regional language" to languages spoken by minorities of more than 10% of the total population. The law also defines the group of languages that are eligible for regional language status, including Crimean Tatar in Crimea, Romanian in the Chernivtsi region and Hungarian in the Zakarpattyia region. The bill allows the parliament, government, and other legislative and executive bodies to publish their decisions in the regional language, TV companies to broadcast in that language, and schools to create separate classes for the minority language speakers.

Kommersant

July 31, 2012

Verkhovna Rada Speaker Volodymyr Lytvyn signed Bill no. 9073 containing principles of the state language policy that expands the sphere of the Russian language in the regions. The document has been sent for signature to Ukrainian President Viktor Yanukovich, who has the right to veto the bill.

Note:

The law guarantees the free use of regional languages in Ukraine, including Russian, Belarusian, Bulgarian, Armenian, Gagauz, Yiddish, Crimean Tatar, Moldavian, German, Greek, Polish, Romanes, Romanian, Slovak, Hungarian, Rusyn, Karaim, and Krymchak. The bill would allow a given territory to declare a second official language if at least 10% of the people living in the area speak that language.

Opposition parties said the vote on the bill violated the norms of the Constitution of Ukraine.

RBK

MILITARY AND POLITICAL COOPERATION

KADEX-2012 opens in Astana

May 3, 2012

Kazakhstan's second international military exhibition, KADEX-2012, opened in Astana. The opening ceremony was led by the President of Kazakhstan Nursultan Nazarbayev. Rosoboronexport, United Shipbuilding Corporation, United Aircraft Corporation, Oboronprom Corporation and UralVagonZavod participated in the exhibition.

Rosoboronexport plans to hold talks with the representatives of Kazakhstan's Defence Ministry on rearming the Kazakh military with Russian weapons and military equipment. Rosoboronexport is ready to supply military air equipment and a range of items for the ground troops.

According to experts, Russia is interested in developing military and technical cooperation with Kazakhstan, given the presence of several major military and industrial companies at the exhibition. Russia is currently in the process of transforming its international status of that of a major global player supplying many regions around the world (Venezuela, Algeria, China and India are well-equipped with Russian arms) to a more pragmatic and self-restrained one.

Following the results of the exhibition, Moscow and Astana signed a memorandum on the acquisition of nine units of the Russian-made "Terminator" tank support combat vehicle (BMPT). The parties agreed that, starting from 2013, Kazakhstan will purchase three BMPT a year. However, Rosoboronexport is still to negotiate and agree on the BMPT's cost with Kazakhstan.

Kommersant-Online

Central Asia set to receive US military equipment from Afghanistan

June 15, 2012

The US and NATO forces are to leave Afghanistan by 2014. After the withdrawal, some of the US military equipment may remain in various Central Asian states.

Sources close to the defence ministries of the Central Asian republics say that the Pentagon is studying the possibility to transfer weapons and military equipment, now being used by the International Security Assistance Force (ISAF) in Afghanistan, to Kyrgyzstan, Uzbekistan and Tajikistan after 2014.

The Central Asian states will receive some of the equipment, including armoured vehicles, tank transporters, tractive vehicles, fuel transporters, special-purpose graders, bulldozers and water trucks, free of charge, while the rest of the military hardware will be stored for safekeeping at local facilities.

At present, the ISAF forces in Afghanistan use 8,000 mine-resistant, ambush-protected vehicles (MRAP), 6,900 MRAP all-terrain vehicles, and over 10,000 high mobility multipurpose wheeled vehicles (Humvee). In addition, the Pentagon is ready to hand over medical equipment, communications systems, fire extinguishing means and even mobile gyms and other household facilities to Afghanistan's neighbours. Pentagon analysts believe that it would be inexpedient to ship most of this equipment home or to leave it in Afghanistan.

The Kyrgyz Defence Ministry's officials confirmed that talks with the Pentagon are in progress. The US seeks to discuss these matters without the involvement of regional organisations such as the Collective Security Treaty Organisation.

A Russian diplomat said this scenario ran counter to specific agreements with Moscow's Central Asian partners and other agreements within the CSTO framework. Thus, for instance, in December 2011, the CSTO member states agreed that no foreign military facilities may be deployed in any of the CSTO countries without the sanction of all CSTO member states.

Kommersant

Russia, CSTO to produce military goods

June 15, 2012

Russian President Vladimir Putin signed a law on ratification of the agreement on cooperation between the CSTO member states in the development, production, operation, repair, modernisation, service life extension and utilisation of military goods. The procedures for these operations will be governed by separate agreements.

According to the document, the parties have no right to transfer military goods received under the current agreement to third countries or international organisations, or to individuals or entities, without prior written authorisation from the supplier.

Moreover, Putin signed a law on ratification of the agreement on procedures for formation and functioning of forces and resources of the CSTO Collective Security System.

Expert Online

Uzbekistan declines CSTO membership

June 28, 2012

In an official note to the Collective Security Treaty Organisation, Uzbekistan declared that it had declined membership in the CSTO. Among other reasons to withdraw from the Russia-led security agreement, Uzbek authorities claim that they are not satisfied with the CSTO's strategic vision vis-à-vis Afghanistan and with strengthening military cooperation between CSTO member states. The CSTO is yet to provide an official response. The CSTO agreement stipulates the right of any CSTO member to opt out of the organisation at any time, a right that was previously exercised by Georgia.

Uzbekistan's decision to withdraw from the CSTO does not come as much of a surprise. The country first quit the bloc in 1999 and joined GUUAM instead, giving the go-ahead to active cooperation with the West, which resulted in an agreement with the US on the use of Karshi-Khanabad airbase during an operation in Afghanistan. This was followed by the Andijon unrest, which was suppressed by Uzbek authorities, and a cooling of relations with the West. Tashkent returned Uzbekistan to the CSTO in 2006, and the US military left Karshi-Khanabad. However, in recent years, Tashkent has again stopped taking part in CSTO activities.

Experts believe that Uzbekistan's current decision to quit the CSTO is closely related to the upcoming US withdrawal from Afghanistan. By opting out of the organisation, Tashkent also hopes to settle some controversial matters with Tajikistan, including the project for construction of the Rogun HPP. It is possible that Dushanbe and Bishkek will also clarify their plans towards Washington and Moscow in the near future.

Kommersant, Vedomosti

Russia's military cooperation with Central Asia put under challenge

July 12, 2012

Tajikistan followed Kyrgyzstan's example and demanded a substantial increase in the annual rent for the deployment of a Russian military base in the republic.

A dispute over the terms of the deployment of 7,000 Russian soldiers in Tajikistan erupted in early July after Russia accused the Tajik authorities of putting forward unacceptable conditions to prolong the facility's use, and stopped funding it. The Tajik Defence Ministry, for its part, dismissed Russia's stance on this matter as "politically inappropriate".

Kyrgyzstan voiced similar demands some time earlier. The country's authorities plan to increase rent for three Russian military bases starting from 2014, when the current lease agreement expires. The bases for which Kyrgyzstan is raising payments are the underwater weapons testing base in Karakol, the military communications centre in Kara-Balta and the radio-seismic laboratory in Mailuu-Suu.

Experts note several simultaneous problems arising in the field of military cooperation between Russia and its partners, ranging from the disputes over the lease of Gabala Radar Station in Azerbaijan and the suspension of Uzbekistan's membership of the CSTO to the rent increases for its military bases in Tajikistan and Kyrgyzstan. Moreover, analysts believe that, given the global crisis and the lack of significant income, Tajikistan and Kyrgyzstan view their military bases as sources of commercial benefits rather than a geopolitical issue. And in the absence of projects that could link Russia with this part of Central Asia, Russia will have to pay more, as it has almost no other mechanisms that would offset its withdrawal from the region.

Note:

A week later Tajikistan agreed to Russia's terms for extending the lease on its military base on the same basis as for the 201st motorised rifle division deployed in Dushanbe, Kurgan-Tyube, and Kulyab, Russia's Ground Forces commander Vladimir Chirkin said.

RBK

Russia and Ukraine strengthen military cooperation

August 22, 2012

Russian Defence Minister Anatoly Serdyukov and his Ukrainian counterpart Dmytro Salamatin held talks in Kyiv and approved several projects that would strengthen military cooperation between the two states. The parties signed a protocol on the use of the NITKA ground-based naval pilot training centre in Crimea. Under the protocol, Russia will pay \$1.6 million a year for the use of the training centre. Moreover, the protocol allows NITKA to be used for training Indian MIG-29K pilots under Rosoboronexport's contract with India on the sale and delivery of the Vikramaditya aircraft carrier.

The defence ministers also agreed on developing a five-year military and technical cooperation programme to last until 2017, free training of Ukrainian

officers in Russia, joint military exercises and the use of Ukrainian enterprises for the repair and disposal of the Black Sea Fleet's weapons.

However, a major project for the development of AN-70 military transport aircraft was not included on the agenda of the defence ministers' meeting due to disagreements over the price. In addition, talks over modifying the AN-70 documentation to fit the new requirements of the Russian Air Force and the papers' transfer to Russia for digitisation came to a deadlock.

Vedomosti

Uzbekistan bans military bases

August 31, 2012

Uzbekistan's Senate ratified the Foreign Policy Concept, initiated by Uzbek President Islam Karimov. The Concept bans the establishment of any foreign military bases or facilities in the republic. In addition, Uzbekistan reserves the right to withdraw from any interstate structures if they are transformed into military blocs. Moreover, the country will not participate in any peacekeeping operations, and therefore "Uzbek soldiers would never fight abroad".

However, the ban on foreign military base deployment will not result in the suspension of military cooperation with the US. The Uzbek Senate ratified the agreement between the countries on air transit of ISAF freight and personnel from Afghanistan through Uzbekistan. According to the agreement, transit may be carried out on nonstop flights and with the permission of the Uzbek state.

Note:

The US and Uzbekistan reached a verbal agreement on the backhaul of military freight from Afghanistan during the May NATO summit in Chicago and signed a corresponding memorandum in July 2012. Under the agreement Uzbekistan will receive some of the military equipment free of charge, while the other part of the military hardware will be stored in safekeeping at local facilities.

Kommersant-Online

CSTO CRRF joint drills held in Armenia

September 17, 2012

Joint military exercises of the CSTO Collective Rapid Reaction Force (CRRF), called Interaction-2012, were held at the Marshal Bagramyan firing range in Armenia.

Approximately 2,000 servicemen from Russia, Armenia, Belarus, Kyrgyzstan, Kazakhstan and Tajikistan took part in the military exercises, utilising over 500 units of military weaponry, 50 units of artillery, and 200 units of

automotive equipment. The leadership of the drills noted a high level of teamwork between the CRRF troops and Special Forces units of the ministries of internal affairs and ministries of emergency situations of the CSTO member states.

Interaction-2012 Press Service

Russia and Azerbaijan at impasse over Gabala Radar Station

Since the collapse of the Soviet Union, the Gabala missile defence radar station in the Azeri town of Gabala has long been operated by the Russian military without negotiations over its legal status. In 2002, Moscow and Baku signed a ten-year lease agreement that specified conditions of use for the Gabala radar station, including an annual fee of \$7 million for leasing the site. Gabala made headlines in 2007 when President Vladimir Putin offered to share the radar station with the United States in an effort to end the controversy over NATO's plans to build a missile defence system in Poland and the Czech Republic. The US rejected the offer. In 2010-2011, Russian officials repeatedly mentioned their plans to modernise the Gabala radar station and to replace it with a new generation radar station of Voronezh-VP type by 2020. However, in February 2012 Azerbaijan voiced its intention to raise the annual rent charge from the current \$7 million to \$300 million a year.

May 25, 2012

Azerbaijan's move to raise Russia's lease payment for the Gabala radar station and limit the lease term to three years makes the lease of Azerbaijan's station purposeless. The Gabala radar needs a major overhaul, while the annual rent for the Gabala radar as proposed by Azerbaijan is equivalent to the cost of constructing two new Voronezh-DM stations on Russian soil. A new Voronezh-DM radar station outside Armavir in the southern Russian region of Krasnodar could perform the same functions and cover the area previously assigned to the Gabala station, and so Gabala carries no essential political or military meaning for Russia.

Vedomosti, Kommersant-Online

December 11, 2012

Russia and Azerbaijan failed to agree on the rent charge for the Gabala Radar Station. Thus, the Russian Foreign Ministry confirmed that Russia shut down operations at the station following the expiration of the agreement between the governments of Azerbaijan and the Russian Federation on the status, principles and conditions for use of the Gabala Radar Station on December 9, 2012.

Expert Online

Moscow and Bishkek sign military base deal

September 20, 2012

Following talks, the presidents of Russia and Kyrgyzstan signed an agreement on deploying a Russian joint military base in Kyrgyzstan, ensuring Russia's long-term military presence in Central Asia.

The 15-year base agreement, signed by the two nations' leaders, will come into effect in 2017 with a possible five-year extension. The freshly-signed agreement details the status and conditions of the military base deployment and also regulates the rental price.

Moreover, Russia pledged to help Kyrgyzstan develop the Manas airport in Bishkek when the US military leaves the Manas air base after 2014, when international forces are scheduled to wrap up their Afghan mission.

Expert Online

Russia, Tajikistan seal military base deal

October 8, 2012

The defence ministers of Russia and Tajikistan signed an agreement prolonging Russia's lease on a military base in the former Soviet republic until 2042 with the option of repeatedly extending it for five years at a time after that date. The agreement extends a deal signed in 1993, which was due to expire in 2014. No rent will be charged, and the Russian military will have the status of administrative and technical staff of diplomatic missions. At the same time the ministers signed a memorandum on military cooperation, which provides for development of a programme for the modernisation and renovation of Tajikistan's armed forces, and acquisition of modern arms. Russia will also assist in training Tajik officers in Russia.

However, the zero rent payment for the base does not imply that it is absolutely free of charge. The energy ministers of both states signed a memorandum on the abolition of duties on oil supplies from Russia (about 1 million tonnes of oil per year), resulting in a gain in excess of \$100 million a year for Tajikistan's economy. The strengthening of Tajik-Russian ties comes amid deterioration of Tajik-Uzbek relations.

Vedomosti, Expert Online

Russia to spend over \$1 billion on Kyrgyz and Tajik military

November 6, 2012

Faced with US attempts to put a squeeze on Russian influence in Central Asia, Moscow is taking measures to bolster its position in the region. Russia is prepared to spend \$1.1 billion on rearming Kyrgyzstan's military with all types

of small arms, new infantry combat vehicles and combat reconnaissance patrol vehicles, helicopters, field and stationary hospitals, as well as light vehicles, portable mortar launchers and satellite equipment. The programme for training Kyrgyz servicemen in Russia will also be significantly expanded. Agreements to this effect were reached during the visits to Bishkek by Deputy Prime Minister Igor Shuvalov in August and President Vladimir Putin in September.

In addition, Tajikistan is reportedly receiving \$200 million in air defence system upgrades and current hardware repairs. Tajikistan will also receive a \$200 million discount on fuel deliveries from Russia.

By helping Kyrgyzstan and Tajikistan modernise their military, Moscow expects to strengthen the potential of the CSTO in the light of the forthcoming American withdrawal from Afghanistan in 2014.

Expert Online, Kommersant

Uzbekistan pledges not to host any US military facilities

December 19, 2012

Despite having officially suspended its membership in a Russia-led CSTO, Uzbekistan assured Russia that no US military bases will be deployed in the territory of the republic. Russian Foreign Minister Sergei Lavrov said earlier that Russia regrets Uzbekistan's decision to pull out of the CSTO, but confirmed that the two countries will remain allies.

Uzbekistan withdrew from the CSTO for the first time in 1999, but in August 2006, when Karimov's image was damaged by the attack on the demonstration in Andijan, restored its membership in the organisation. In late June 2012, Uzbekistan filed a note with the CSTO Secretariat on the suspension of its participation in the bloc.

Expert Online, Kommersant

Multilateral Development Banks: Overview of Activities in 2012

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This publication aims to review the activities of multilateral development banks (MDBs) in CIS member countries. The international financial organisations operating in the region include the Asian Development Bank (ADB), the World Bank (WB) Group, the Eurasian Development Bank (EDB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB), the Islamic Development Bank (IsDB), the Black Sea Trade and Development Bank (BSTDB), and the Nordic Investment Bank (NIB).

The review is based on the data listed on the afore-named MDBs’ official websites. It should be noted, however, that the annual reports for 2012 had not been published when this article was written, so it is based on official press releases published by the MDBs.

The first part of the overview focuses on cooperation between the MDBs for the purpose of boosting their efficiency in various spheres of activities while the second section of the current paper is devoted to the MDBs’ prime objectives in 2012. The third part dwells upon the MDBs’ 2012 investment activities in the countries of the region.

1. DEVELOPING COOPERATION IN VARIOUS FIELDS OF ACTIVITIES

The year 2012 was marked by the development of cooperation between the MDBs in various fields of activities. Joint initiatives aimed at improving the effectiveness of aid, both in general and in specific areas, came to the fore. The issues of expertise, financing, monitoring and management of investment projects, as well as banking risk management and project analysis in the field of renewable energy also topped the MDBs' cooperation agenda.

The MDBs' interaction in developing Islamic finance in order to help deepen its understanding and build the capacity for the development of institutions and instruments for sustainable growth is of particular importance. To this end, the WB and the IsDB, the Islamic Financial Services Board (IFSB) and the ADB have signed memoranda of understanding, paving ways for cooperation between the organisations to support global, regional and national efforts in the development of Islamic finance.

In 2012, the MDBs continued to boost cooperation in the sectors of energy, water, education, transport, agriculture and health. To this end, the ADB and the OPEC Fund for International Development (OFID) signed a framework agreement on joint financing of projects in the public sector in Asia Pacific.

Pursuing its efforts to improve energy efficiency in all countries of operations, the EBRD has intensified cooperation with the International Confederation of Energy Regulators (ICER) by signing a memorandum of understanding to share information and examine global best practice in order to promote reforms in the energy infrastructure sector.

The IsDB and the EIB have signed a memorandum of understanding in order to step up cooperation, especially in the Mediterranean region. The memorandum is designed to give a new impetus to a strong partnership between the two organisations.

The MDBs have also continued to cooperate with state and non-profit organisations. For instance, on May 2, 2012 the Prime Minister of the Republic of Kazakhstan, Karim Masimov, visited the EIB office in Luxembourg to discuss current and future cooperation between Kazakhstan and the EIB. The EIB has pledged to support Kazakhstan in implementing the national development strategy and diversifying the economy, both through the provision of long-term financing and the use of the EIB's know-how. The parties have also discussed possible project financing, particularly in the areas of social and economic infrastructure, mitigation of climate change and private sector development in Kazakhstan.

On June 22, 2012 the EDB and the Chamber of Commerce and Industry of the Russian Federation signed an agreement on cooperation in order to improve the

investment climate and overcome barriers to the development of entrepreneurial business in Russia.

The ADB partnered with the World Bank and the Organisation for Economic Cooperation and Development (OECD) in the AidFlows project designed to support increased transparency on flows of development funds from donors to beneficiary countries. The one-of-a-kind online resource provides aggregate data on official development assistance, including funding from donors, the OECD countries and development banks, arranged by the amounts, sectors and types of financing, from both donor and beneficiary views.

2. PRIORITY AREAS OF ACTIVITY IN 2012

The issues surrounding developmental aid to individual countries in the region have traditionally remained relevant with power industry and energy efficiency, environment and climate change, public-private partnerships and infrastructure development, trade and trade finance, SME and microfinance remaining in the spotlight. These areas of MDB activities are discussed hereafter in this section of the paper.

Energy Efficiency and Power Industry

Energy efficiency was one of the key areas of MDB activity in 2012. The lack of power generating capacity and natural gas shortage in many of the region's countries, as well as global climate change and rising energy costs underline the need for the development of energy efficiency programmes. However, despite the high proportion of private businesses interested in energy saving, these programmes remain quite costly and are unlikely to turn into profitable business in the near future. Therefore, the MDBs are trying to find solutions to this problem, with their assistance often being the only possible source of funding, making it even more important.

Investment in sustainable energy may be significantly increased via the implementation of equipment standards that encourage the use of high-end technology, as well as the provision of appropriate incentives for further investment in the development and implementation of high-performance solutions inter alia.

The EBRD, for instance, contributed to the implementation of national action plans on sustainable energy in 8 countries, including Armenia, Bulgaria, Georgia, Kazakhstan, Moldova, Russia, Turkey and Ukraine. Moreover, with the launch of its Sustainable Energy Initiative (SEI) (2006-2012), the EBRD's investments in energy efficiency and renewable energy sources topped \$13 billion and the Bank intends to invest a further €5-6 billion under the SEI by 2014.

The new EBRD's Ukraine Sustainable Energy Lending Facility (USELF) represents an investment facility of up to €70 million (€50 million from

the EBRD and €20 million from the Clean Technology Fund) for fostering private renewable energy projects in Ukraine. Technical assistance in project preparation, regulatory framework development and strategic environmental impact assessment is financed by a grant from the Global Environment Facility (GEF).

In 2012 the EBRD established the Moldovan Residential Energy Efficiency Financing Facility (MoREEFF), a new financing facility of up to €35 million to support energy efficiency investments in the Moldovan residential sector. Over the next five years, loans under the MoREEFF will be provided through credit lines extended to commercial banks participating in the programme for the financing of eligible residential energy efficiency improvements that will include the installation of energy efficient windows, the insulation of walls, roofs and floors, and the use of gas boilers, solar water systems, heat pump systems and rooftop solar panels. Any borrower under MoREEFF is entitled to receive a grant of 20%, 30% or even up to 35% of the loan amount, respectively, towards the cost of the energy saving project, once it has been completed (and subject to MoREEFF's terms and conditions). This facility is already in use. Under MoREEFF, Moldindconbank has signed a €5 million transaction for onward-lending to private individuals and condominium associations. Procredit Bank is planning to join the facility to offer the MoREEFF loans in the near future. Other banks have also expressed interest in the financing programme and are said to join at later stages.

2012 saw other MDBs also paying attention to energy efficiency issues. For example, in early June 2012 NIB launched a long-term funding programme aimed at improving energy efficiency in the industrial and district heating sectors in the Russian Federation. The first step of the programme will be to open a consultancy service for potential projects. NIB's Russia Energy Efficiency Programme (REEP) will help potential borrowers in Russia to develop eligible projects and provide funds for them. The funds will be allocated by NIB with Russian Gazprombank and potentially some other intermediary banks. NIB has so far earmarked €60 million for onward-lending to REEP projects.

For support in project development, NIB has contracted the Swedish consultancy company Grontmij AB. Under a two-year contract, the consultants will help identify potential projects, carry out measurements of energy efficiency and environmental assessments, organise training in environmental and energy efficiency related matters as well as assist in promoting REEP in Russia. The consultancy will be financed with grants from Sweden provided through the Ministry of Foreign Affairs and the Swedish International Development Cooperation Agency (SIDA).

IsDB's support for the energy sector in member countries has exceeded 25% of the total financing by the Bank since its inception in 1975. In its mid-July meeting, the IsDB Board of Executive Directors approved more than \$683

million for financing power generation projects as part of \$1.158 billion financing approvals.

In late June 2012 the IFC signed a cooperation agreement with the Association of Regional Banks of Russia to help regional commercial banks develop new products and know-how to expand financing for capital repairs, energy-efficient renovations, and the modernisation of multi-family buildings. The programme is being implemented with financial support from Finland's Ministry of Foreign Affairs and Ministry of Employment, and the Global Environment Facility, in partnership with the EBRD.

In 2012 the EDB signed its first project under the new programme for improving energy efficiency in the Bank's member states by providing targeted credit facilities to local financial institutions. Within the framework of the programme the EDB provided a non-revolving line of credit to JSC Commercial Bank "Centre-invest" to finance energy efficiency projects. In line with the EDB strategy, the energy efficiency programme is one of the Bank's top investment priorities.

In 2012, the World Bank Group allocated \$3.6 billion to finance renewable energy projects (a record 44% of the WB's total energy funding of \$8.2 billion).

Securities Offerings

Last year the debt securities markets provided favourable market conditions for the MDBs due to the special status of these organisations and strong financial results that were well received by investors, allowing a number of banks to raise additional financing.

The **ADB** reported on two bond placements in 2012, including a \$3 billion 5-year global benchmark bond issue. The proceeds of the Bank's first global bond issue of the year formed part of the Bank's ordinary capital resources and will be used in its non-concessional operations. The bonds, which carry a coupon rate of 1.125% per annum payable semiannually and a maturity date of March 15, 2017, were priced at 99.866% to yield 1.152%, or 31.1 basis points over the 0.875% US Treasury notes due December 2016. The issue was marked by the strong interest from investors reflected in an oversubscribed book of more than \$4 billion and over 80 investors. The issue achieved broad primary distribution with about 52% of the bonds placed in Asia, 29% in Europe, Middle East and Africa, and 19% in the Americas. By investor type, around 63% were bought by central banks and official institutions, 20% by fund managers, and 14% by banks, with the balance allocated to a variety of other types of investors. The transaction was lead-managed by Goldman Sachs, JP Morgan, Morgan Stanley, and RBC Capital Markets. A syndicate group was also formed consisting of Bank of America Merrill Lynch, BNP Paribas, Credit Suisse, Daiwa, Deutsche Bank, HSBC, Jefferies, Mitsubishi UFJ Securities, Nomura, and UBS.

The ADB returned to the US dollar bond market with its second placement of a \$1.25 billion 3-year global benchmark bond issue. The bonds, which carry a coupon rate of 0.5% per annum payable semiannually and a maturity date of August 17, 2015, were priced at 99.666% to yield 0.605%, or 19.55 basis points over the 0.25% US Treasury notes due May 2015. The issue achieved wide primary distribution with about 52% of the bonds placed in Asia, 22% in Europe, Middle East and Africa, and 26% in the Americas. By investor type, around 63% were bought by central banks and official institutions, 20% by fund managers, and 17% by banks and other investors. The transaction was lead-managed by Credit Suisse, Deutsche Bank, HSBC, and Nomura. A syndicate group was also formed consisting of Bank of America Merrill Lynch, BNP Paribas, Citigroup, Daiwa, Goldman Sachs, JP Morgan, Morgan Stanley, RBC Capital Markets, and UBS.

In 2012 the **EIB** took the lead among the analysed MDBs in terms of the number and volume of placements. Despite the volatility of markets the Bank managed to raise €71.3 billion last year, compared to the initial target of €60 billion.

The EIB launched its first benchmark transaction of 2012 on January 5, with a new 3-year Sterling (GBP) benchmark maturing in January 2015. The issue was priced at a spread of 160 bps over the UKT 4.75% due September 2015. The order book was opened with a minimum deal size of GBP 300 million. The issue saw strong support from the outset, with orders growing to GBP 350 million in two hours. The book closed reaching over GBP 450 million. It allowed EIB to price an upsized deal of GBP 450 million. With 55 investors taking part, the transaction received a strong response from the UK real money community (88% of the deal), French insurers and Swiss private banks.

Later on the EIB priced its first new €5 billion 3-year benchmark Euro Area Reference Note (EARN) of 2012. The issue carries an annual coupon of 1.625% and has a final maturity date of January 15, 2015. The bond was priced at a spread of mid-swaps plus 38 bps. Central banks and official institutions drove demand for the transaction together with banks (37% each). The total order book exceeded €10 billion. Geographically, there was exceptional demand from Germany (31%) and also strong investor interest from outside Europe (almost 40%), including 23% from Asia.

Moreover, the EIB placed its new long-dated €3 billion benchmark Euro Area Reference Note. The issue carries an annual coupon of 3.5% and has a final maturity date of April 15, 2027. The transaction was EIB's third placement of 2012 and first 15-year EARN benchmark since April 2009. French and German investors drove the bookbuilding process, together taking well over 80% of the issue. Insurance companies and pension funds were the leading source of demand (38%), with banks and fund managers accounting for a large share of the orders. The total order book exceeded €3.3 billion, with 123 investors participating.

The **EBRD** reported on placing a new \$1.5 billion 5-year benchmark bond in 2012. The spread of mid-swaps – 3 basis point was the tightest ever for an EBRD 5-year global benchmark and the 0.75% coupon was the lowest from a supranational issuer in the 5-year sector in 2012. Following considerable interest, particularly from the central bank community from Asia and EMEA, the order book closed at over \$1.5 billion with all orders at reoffer. Approximately 30 investors participated in the transaction. Given the current transaction, the EBRD's 2012 bond placements amounted to an aggregate of €5.25 billion.

BSTDB issued a debut Swiss Franc (CHF) bond. The CHF 200 million (\$216 million), four-year unsecured bond with a coupon of 2.5% had Credit Suisse as sole arranger and attracted more than 50 investors, including asset managers, private banks and retail clients. The bonds with a maturity date of October 4, 2016, were priced at 99.925%. The proceeds of this new issuance will assist BSTDB in meeting its mandate by responding to the funding needs of its clients in the Bank's member countries.

In late April 2012 BSTDB issued \$122 million of Euro Commercial Paper (ECP) under the Bank's special ECP programme signed on April 11, 2012. The programme and the issue were arranged by UBS. The issuance achieved an attractive pricing for the 6 months maturity. The transaction represents a first ECP deal for BSTDB in a strategic move to attract short-term liquidity and to diversify its investor base. By entering the ECP market, BSTDB plans to access new high quality investor types, including money market funds, central banks and in particular private banks.

In February 2012, the **EDB** placed Series 01 rouble denominated bonds with a coupon of 8.50% per annum. Given the market situation, offering price, coupon rate and demand, the order book closed at 5 billion roubles with 50 investors participating. The transaction was lead-managed by VTB Capital, VEB Capital, Raiffeisenbank, RONIN, and Troika Dialog.

Moreover, on September 28, 2012 the EDB launched its debut 5 billion rouble Eurobond with a five-year maturity and a yield guidance of 8.0% per annum. The order book for the issue topped 13 billion roubles. The issue followed the EDB's previous placements of rouble denominated bonds on the domestic market for a total of 20 billion roubles (\$631 million), and two dollar Eurobond issues.

On December 28, 2012 the EDB priced its tenge bonds (KZP01Y05E384) in Kazakhstan for a total amount of 9.9 billion tenge (\$66 million). The issue carries a coupon rate of 6.25% per annum and matures in 2017. The bonds were placed via a special trading session at the Kazakhstan Stock Exchange (KASE) and received an A3 rating from Moody's Investors Service international rating agency. The proceeds of the issue will finance the EDB's investment projects in Kazakhstan.

On November 28, 2012 **IFC** placed an inaugural Volga bond, raising 13 billion roubles (equivalent to about \$410 million) for private sector development. The five-year bond was IFC's first rouble-denominated bond placed in the Russian market, the first corporate bond issued in Russia with a coupon linked to the NES Russian Inflation Target Index, and the largest domestic placement by an international issuer. IFC's bond is aimed at investors who benchmark their returns to the difference between predicted and actual prices. It is linked to an index that broadly approximates the performance of the Russian Consumer Price Index. These inflation-linked issuances will pave the way for a market-based mechanism that can reduce the adverse impacts of inflation on real returns earned by Russian investors. The IFC issues bonds as part of its regular programme of raising funds for private sector development. Rouble proceeds from the Volga bond will be used to invest in private sector companies in Russia. A portion of the proceeds may be swapped into floating-rate US dollar funds that are available for IFC investments in a variety of emerging markets.

Moreover, IFC issued a \$2 billion five-year global bond within the framework of its regular programme of raising funds for private sector development lending. The transaction was lead managed by Deutsche Bank, JP Morgan, and Nomura International. The deal attracted broad demand from investors in Asia, EMEA and the Americas with 86% of the issue going to central banks and official institutions, 8% to banks and corporations, and 6% to fund managers. During the fiscal year 2012, IFC raised \$10 billion across a range of markets and currencies. US dollar borrowings account for about 70% of IFC's funding programme.

In the period under review **NIB** reported on placing a new 5-year global \$1 billion benchmark bond. The bond was priced 17 bps over the US Treasury bond, the tightest pricing NIB has ever achieved for a 5-year benchmark versus US Treasuries. BofAML, Deutsche Bank, HSBC and Nomura were the lead managers for the transaction. The superior quality and granular order book comprised nearly 40 investors. Thus, NIB's funding programme for 2012 was increased to approximately €4 billion. This transaction completed the funding programme.

Environmental Issues and Mitigation of Climate Change

Environmental issues and mitigation of climate change hold a dominant position in the scope of activities by MDBs.

According to the WB research, the development and implementation of clean technologies requires significant investment with about \$0.6-\$1.5 trillion per annum needed to help developing countries move to a low carbon and climate-resilient economy, including \$40 billion to Asia-Pacific alone.

In 2012, six leading MDBs, namely the African Development Bank, ADB, EBRD, EIB, the Inter-American Development Bank and the WB Group, made a

joint statement pledging to significantly expand their investments in sustainable development (currently \$93 billion per year) to support global development priorities.

The MDBs underlined that the need to move towards green growth is key to sustainable development and prosperity. The MDBs pledged to further engage both the public and private sectors in financing.

The MDBs are also working on establishing a unified method to track funding allocated for climate change mitigation and adaptation projects, and a greenhouse gas accounting and reporting system in the global effort to improve control over the climate finance flows and effectiveness. To this end, four leading global organisations signed a Memorandum of Understanding to create the Green Growth Knowledge Platform, a cutting edge global initiative that will identify and address major knowledge gaps in green growth theory and practice. The Green Growth Knowledge Platform will improve local, national, and global economic policy-making around the world by providing rigorous and relevant analysis of the various synergies and tradeoffs between the economy and the environment. The agreement was signed by the Global Green Growth Institute (GGGI), the Organisation for Economic Cooperation and Development (OECD), the United Nations Environment Programme (UNEP), and the WB.

The year 2012 was also noteworthy for the establishment of a new IFC-financed Climate Catalyst Fund LP, a private equity fund of funds focused on providing growth capital for companies delivering resource efficiency and low-emission products and services in emerging markets. The fund intends to assemble a diversified portfolio of private equity funds, and make direct co-investments in early and growth-stage companies that are developing innovative technologies and helping to reduce climate change.

Work within the framework of Climate Investment Funds (CIF) continued. By late 2012, the CIF had raised \$7.2 billion in commitments from 14 donor countries. It is assumed that a combination of grants, soft loans and loans with little to zero interest rates, as well as risk mitigation instruments from CIF may attract an additional \$43 billion as co-financing.

CIF funding is channeled through the five partner MDBs – African Development Bank, ADB, EBRD, IDB, and the WB Group. CIF plan to allocate over \$6 billion to finance more than 200 projects in 48 developing countries. ADB acts as a partner, helping to distribute the funds among the Bank's developing member states, providing technical assistance and co-financing projects from its own resources.

Joining the MDBs' efforts to promote environmental projects and mitigate climate change, IFC launched the Sustainable Banking Network in the second half of 2012 to help Bank regulators in emerging markets develop green-credit

policies and environmental and social risk-management guidelines by sharing knowledge and technical resources.

In cooperation with the OECD, the UNEP and the GGGI, the World Bank launched several information portals, including the Climate Change Knowledge Portal, the Climate Finance Options Platform and the Green Growth Knowledge Platform, to provide stakeholders with the latest information, analysis and tools related to climate change. Moreover, the WB issued approximately \$3.3 billion in Green Bonds in 17 different currencies to combat climate change.

The establishment of the Pilot Asia-Pacific Climate Technology Finance Centre (CTFC) at the ADB became another important step in addressing the issue of climate change mitigation. The CTFC, which is part of a wider partnership among ADB, the Global Environment Facility and the UNEP, works closely with investors, technology suppliers and other partners from across the region and around the world.

Business Activity Support

In 2012, the MDBs continued to support the development of entrepreneurship and expansion of access to finance for small businesses and individuals, which remains a priority for many developing countries, given an acute shortage of credit financing for business.

Thus, in the year under review, IFC together with the EBRD, the Dutch Development Bank (FMO) and BSTDB signed an agreement to support the development of small and medium-sized enterprises (SMEs) in the Caucasus by investing in a new Caucasus Growth Fund. The MDBs initially provide \$40 million and the Small Enterprise Assistance Funds (SEAF) contribute additional \$2 million to the Fund, with a target size of \$70 million. The Caucasus Growth Fund is the first institutional-quality fund dedicated to providing debt and equity capital to SMEs in Georgia, Azerbaijan and Armenia.

In addition, IFC announced a \$200 million investment in the new Global SME Finance Facility, the first global platform of its kind, which blends donor funding with funding from international development institutions in order to expand lending to small businesses in emerging markets. The United Kingdom's Department for International Development (DFID), with an investment of \$63 million, became the facility's first donor. DFID will also provide \$52 million for an advisory component to strengthen the business environment, develop financial infrastructure and commercial banks' capacity for SME financing. IFC and other development institutions will invest a combined \$600 million through the facility in the first phase, of which \$200 million is from IFC's own account. Over time the facility could grow to \$1.8 billion with funds from additional development institutions and donors.

Moreover, the IFC launched a new programme to train microfinance practitioners in Kyrgyzstan and Tajikistan, Azerbaijan and Uzbekistan. The project is aimed at strengthening the financial markets in the region by improving credit information systems, risk-management practices and professional training, as well as by tackling non-performing loans.

In addition to establishing new SME growth funds, the MDBs continued providing financing within the framework of existing programmes. More details on SMEs' projects approved for financing in 2012 can be found in the third section of the current paper.

Trade and Trade Financing

While changing market conditions are threatening the availability of trade finance in the regions of the world where it is needed most, the MDBs have taken several steps to alleviate the lack of financial resources and spur economic growth in emerging markets and developing countries worldwide.

Thus, IFC signed an agreement with Credit Europe Bank of Russia within the framework of its Global Trade Finance Programme that unites more than 200 banks in 90 developing countries. The agreement will help smaller businesses in Russia connect with international customers and suppliers via providing Credit Europe Bank with a \$10 million guarantee, thus expanding the Bank's capacity to finance the foreign trade transactions of its customers and connect to the global network of participating partner banks.

In addition to this, the IFC established a trade-finance guarantee facility for Kazakhstan's Subsidiary Bank of Sberbank of Russia, which had signed on as an issuing bank in IFC's Global Trade Finance Programme. The facility is expected to improve access to financing and new markets for Kazakhstan's private sector exporters and importers, and enhance SB Sberbank's capacity to build relationships with leading international and regional financial institutions, particularly in Asia.

In 2012, the ADB launched a new Supply Chain Finance Programme (SCFP) that is set to bring over \$1 billion to help cash-strapped small and medium-sized enterprises in Asia and the Pacific access capital that can help them grow. The ADB is supplying up to \$200 million for the SCFP, which will revolve at least twice a year because of the short-term maturities involved in supply chains. Furthermore, the \$200 million is estimated to attract an additional \$300 million, at least, in private sector investment through the SCFP. The SCFP will improve suppliers' and distributors' access to cash flow within a supply chain, meaning that they will be able to expand operations and employ more people. The new SCFP will complement the ADB's Trade Finance Programme (TFP) by assuming nonbank commercial risk for both cross-border and domestic transactions within a supply chain.

ADB has made significant progress in supporting trade under the TFP. In the period under review ADB and the OPEC Fund for International Development signed a risk distribution agreement to support trade in emerging Asian countries under the ADB's TFP. The agreement will support an estimated incremental trade flow of \$0.8–\$1.2 billion in countries such as Bangladesh, Mongolia, Pakistan, Sri Lanka and Uzbekistan, and other markets where financing from private financial institutions is limited. The ADB's TFP fills private sector market gaps in trade finance by providing guarantees and loans through over 200 partner banks to support trade. The TFP supports hundreds of SMEs in developing Asia and is expected to record approximately \$4 billion in annual turnover in 2012 through more than 2,000 transactions. The TFP operates in 18 developing markets. The TFP broadens the OFID's instruments for poverty alleviation and economic development

In addition to providing funds via their programmes, MDBs conducted training workshops on trade finance issues to help banks learn new trade finance products and expand the range of financial services available to their clients engaged in the export and import of goods. Participants of such workshops also learned how to identify and mitigate operational risks by adopting best practices of trade finance.

Strategies and Plans

In 2012, MDBs continued their work in the field of strategic planning. Thus, on December 7, 2012 the **EDB** Board endorsed the Bank's 2012 outcomes and plans for 2013. The EDB Board appointed Russian Finance Minister Anton Siluanov as its chairman. The EDB Board took note of the report on project activities in 2012 and approved the budget for 2013.

Last year **EIB** issued new projections for its funding activities, as part of the annual revision of its Corporate Operational Plan (COP). The Bank plans to borrow €70 billion in 2013. This is similar to the amount of €71 billion ultimately raised in 2012, which included some prefunding for 2013. The issuance of a new plan for 2013 follows approval by the Board of Directors of the new COP for 2013–2015. The €70 billion funding programme is in the context of plans for increased lending activity, predicated on a capital increase of €10 billion to be fully paid-in.

The **EBRD** adopted a new strategy for Russia for 2013–2015, prioritising investments and reforms that help to diversify and modernise the Russian economy, spur innovation, increase the role of the private sector, and promote the development of regions that are less advanced than Moscow and St. Petersburg. At the regional level, the Bank will focus on projects that increase economic opportunities for the emerging middle class by securing increased access to finance for local SMEs, as well as by supporting urban renewal and improving the quality of jobs and services. The document stresses that improving

the investment climate in Russia, as well as standards of business conduct and corporate governance, remains a major challenge, particularly at the regional level. The EBRD stands ready to support public private partnerships (PPPs), pre-privatisation investments in cases where there is a clear timetable for achieving private ownership and control, and municipal infrastructure projects in cases where private solutions are not available. Energy efficiency projects will also be at the centre of the Bank's attention.

The **WB Group** released its new Environment Strategy for 2012-2022 aimed at supporting countries to pursue sustainable development pathways that are green, inclusive, efficient, and affordable. The new Strategy responds to calls from governments and the private sector for new approaches to development in light of unprecedented environmental challenges and lays out a vision for "a green, clean and resilient world for all".

Public Private Partnership (PPP)

In 2012, MDBs continued to focus on PPP projects. ADB commissioned a new study, according to which Asia and the Pacific has seen a boom in public private partnerships (PPPs) in the past decade but needs more effective public sector oversight agencies, and in some instances more political will, to advance the process even further.

The 2011 Infrascopes, conducted by the Economist Intelligence Unit (an analytical unit of The Economist, the British weekly news magazine), uses a benchmark index system to rank the readiness and capacity of a country to carry out sustainable, long-term PPP projects. In order to leverage \$8 trillion required over the next decade for physical infrastructure in Asia, public financiers like ADB must undergo a complete change of mindset and shift their focus from sovereign projects to PPPs. The assessment, carried out on 11 developing economies in the region, along with four benchmark countries, and one state, Gujarat in India, shows an increasingly open environment for PPPs, though with individual countries at different stages of readiness. While overall prospects for PPP development remain bright, governments need to continue reforms and address capacity gaps for the design and implementation of effective projects.

In addition to research activities the MDBs continued financing PPP projects in the first half of 2012. Therefore, a pool of banks, including the EDB, EBRD, IFC, NIB, BSTDB, Vnesheconombank, and a number of commercial banks, transferred the first tranche of a loan to finance the PPP project for reconstruction, development and operation of the Pulkovo airport in St. Petersburg in the amount of €5 million. While issuing the first tranche the MDBs have tested a new investment mechanism allowing all creditor banks to synchronise and harmonise actions and the agent bank to take into account the specific features of each of the lenders while conducting the transaction. Hereafter the tranches

will be issued in a regular mode, as stipulated by the agreement. Total funding amounts to €716 million.

The EBRD is committed to assisting Ukraine with the modernisation of the country's gas transportation system under the terms of a March 2009 Memorandum of Understanding signed by the European Union, the EIB, the WB, the EBRD and Ukraine. As part of the signed Memorandum, Ukraine must reform its gas markets and restructure national gas company Naftogaz.

The EBRD and EIB are working on a \$308 million loan agreement to facilitate the emergency repairs to the Urengoy-Pomary-Uzhgorod export pipeline that are necessary for safe and uninterrupted gas transit to Europe.

3. BRIEF RESULTS OF MDB INVESTMENT ACTIVITY IN 2012

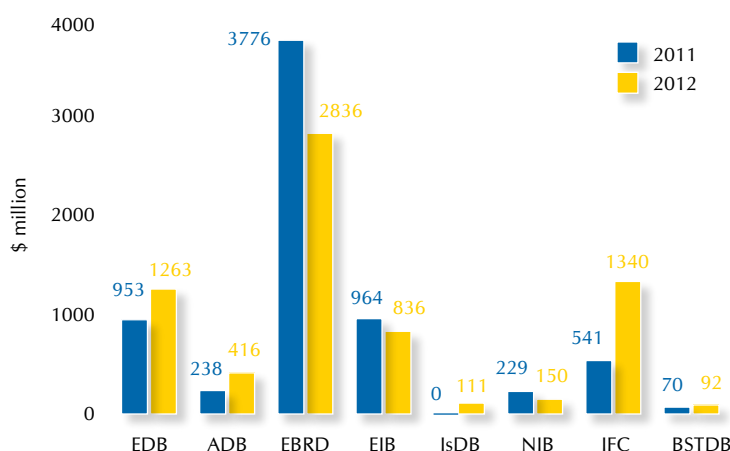
This chapter reviews MDB investment activity in 2012 in the CIS countries, including loans, equity investment, guarantees and grants, as well as special sovereign loans. The review is based on the data provided on the official websites of the MDBs operating in the region, including the ADB, IFC, EDB, EBRD, BSTDB, EIB, IsDB, and NIB.

3.1. Financing approved in 2012

Investment loans, project financing, guarantees and equity investment

In 2012 eight MDBs (ADB, EDB, EBRD, EIB, IsDB, NIB, IFC, BSTDB) approved financing for 160 projects, including investment loans, guarantees and equity investments (hereinafter referred to as "investment project financing") for a total amount of \$7 billion¹, up 3% (\$0.2 billion) compared to 2011 (see Figure 16.1).

Figure 16.1.
Investment project
financing approved
in 2011-2012,
\$ million



¹ Here and below all transactions are converted into USD at the exchange rates set by the Central Bank of Russia and valid on 30.12.2012: EUR/USD 1.3245; USD/RUB 30.3727

The EBRD has traditionally become the leader in terms of approved investment project financing and the number of projects in the CIS member states, having provided over \$2.8 billion for 70 projects, which accounts for 40% of the total funding approved by the MDBs in 2012. The EDB took a stable weighty share of 18% of the total: in 2012 the Bank approved 24 projects worth over \$1.3 billion.

Special sovereign loans, government guaranteed loans and grants

In 2012 six MDBs (ADB, EBRD, EIB, IsDB, NIB and the members of the World Bank Group – IBRD/IDA) and the EurAsEC Anti-Crisis Fund (ACF) with the EDB as fund manager, approved financing for 93 projects, including special sovereign loans, government guaranteed loans and grant aid (hereinafter referred to as "sovereign loans and grants") for a total of \$6.5 billion or 28% (\$1.8 billion) more than in 2011 (see Figure 16.2).

The members of the WB Group, IBRD/IDA, took the lead in terms of approved sovereign loans and grants in the CIS countries, having provided over \$2.2 billion for 34 projects (36% of the total special loans and grants). The BSTDB had not reported on the provision of these forms of financing.

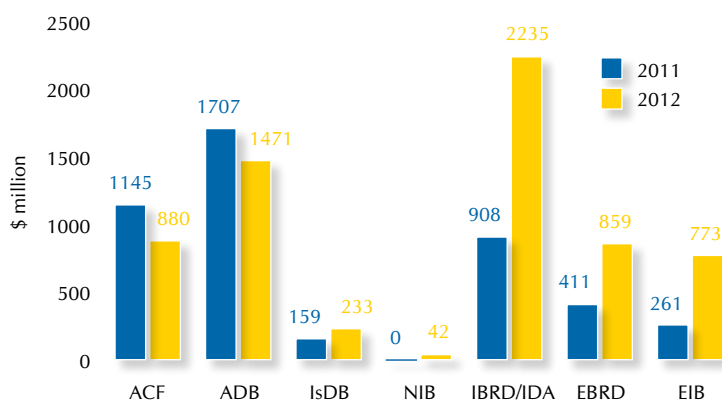


Figure 16.2.
Sovereign loans
and grants approved
in 2011-2012
(\$ million)

3.2. The 2012 investment project financing structured by sectors and countries

The financial sector has accounted for the largest share of 2012 total investments (26%) as a result of the MDB deals with second-tier banks for targeted onward-lending to micro, small and medium-sized enterprises (see Figure 16.3).

A significant share of total MDB investment project financing was allocated to the sectors of transport and transport infrastructure (21%), as well as energy

Figure 16.3.
Investment project
financing by sectors

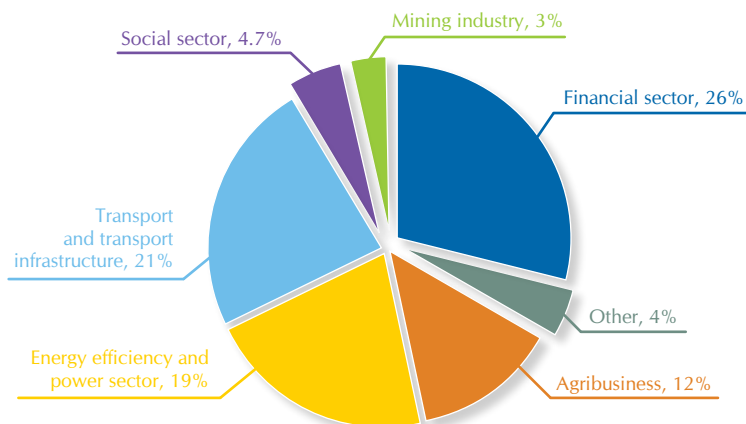


Table 16.1.
The structure of
approved 2012
investment project
financing by
countries

Note: coloured cells indicate that the country is not a member of the specified development bank

efficiency and power (19%), based on the transactions by the EBRD, EDB and NIB (see Annex).

In the period under review, Ukraine and Russia accounted for the greatest volume of investment (\$5.4 billion in aggregate) and the number of investment projects (92), or 77% of the total investment project financing approved by the MDBs in 2012. Russia was in the lead with investments in excess of \$3.95 billion (56% of the total, 60 projects) (see Table 16.1).

Country	EDB	ADB	EBRD	EIB	IsDB	NIB	IFC	BSTDB	Total	
									(\$ million)	no. of projects
Armenia	29		53				40	29	152	13
Azerbaijan			32				15	30	77	7
Belarus	67		70				57		193	7
Kazakhstan	228		150				53		431	14
Kyrgyzstan		10	35				10		55	6
Moldova			97	35			55	8	194	11
Russia	939		1 880	109		150	851	25	3 953	60
Tajikistan			3				7		10	3
Turkmenistan			1						1	1
Uzbekistan		406			111		4		521	6
Ukraine			516	692			249		1 457	32
TOTAL:	1 262	416	2 836	836	111	150	1 340	92	7 044	160
%	17.9%	5.9%	40.3%	11.9%	1.6%	2.1%	19%	1.3%		

During the period under review only three projects worth a total of \$10 million were approved by the EBRD and IFC for Tajikistan. Turkmenistan obtained a \$1 million loan from the EBRD.

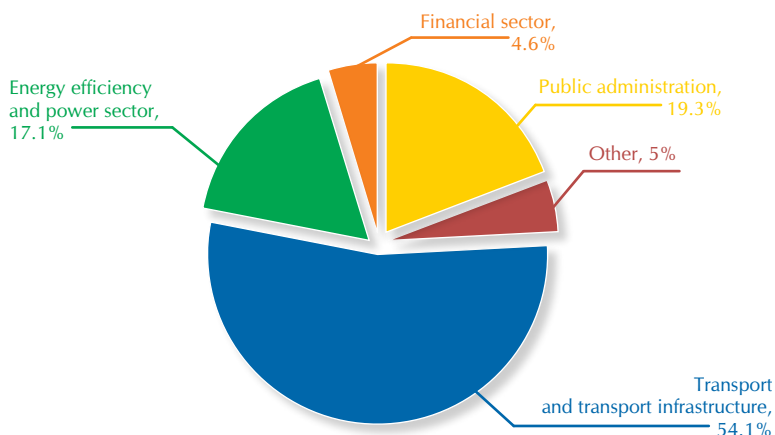


Figure 16.4.
Sovereign loans
and grants by sectors

The sector of transport and transport infrastructure accounted for the largest share (54.1%) in the overall amount of sovereign loans and grants provided in 2012, totalling over \$3.4 billion (see Figure 16.4), due to the large-scale projects in Kazakhstan (an IBRD loan of over \$1 billion to upgrade and construct the Almaty-Khorgos road section of the Western Europe – Western

Table 16.2.
The structure of
approved 2012
sovereign loans and
grants by countries

*Note: coloured
cells indicate
that the country
is not a member
of the specified
development bank*

Country	ACF	ADB	IsDB	NIB	IBRD/ IDA	EBRD	EIB	Total	
								(\$ million)	no. of projects
Armenia	0	42		0	120	20	54	236	15
Azerbaijan		251	0		34			285	5
Belarus	880			33	0			913	3
Kazakhstan		498	0		1 068	259		1 824	8
Kyrgyzstan		98	16		36	5		155	15
Moldova					67	22	0	88	6
Russia				9	40		265	314	3
Turkmenistan								0	0
Tajikistan		107	20		108	49		284	16
Uzbekistan		477	197		302			976	16
Ukraine				0	460	504	454	1 418	6
TOTAL:	880	1 471	233	42	2 235	859	773	6 494	93
%	13.6%	22.7%	3.6%	0.6%	34.4%	13.2%	11.9%		

China international transit corridor) and Russia (a \$328 million EDB loan and a \$252 million EBRD loan to finance the construction and future operation of the Western High Speed Diameter Road in St. Petersburg).

A 17.1% share of 2012 sovereign loans and grants fell on the energy efficiency and power sector (\$1.09 billion), while the public administration sector accounted for 19.3% of the total (\$1.2 billion) due to two ACF tranches for an aggregate of \$880 million to Belarus to support the payment balance and replenish the international reserves.

The MDBs analysed did not report on providing new sovereign loans and grants in Turkmenistan in 2012. Kazakhstan accounted for the largest share of this type of financing (28%) with the ADB, IBRD/IDA and EBRD transport infrastructure projects for a total of over \$1.8 billion (see Table 16.2 and Annex). Ukraine ranked second with a 22% share of the total sovereign loans and grants approved in 2012 for a total sum of \$1.4 billion.

ANNEX. BRIEF INFORMATION ON IMPROVED PROJECTS

ADB

Sovereign loans and grants:

Project	Total (\$ million)	Sector	Note
Azerbaijan			
TA: Second Road Network Development Programme	0.225	Transport and transport infrastructure	The technical assistance will finance the consultants' reports on a future \$500 million project under the Second Road Network Development Programme.
Baku Sustainable Urban Transport Investment Programme	1.05	Transport and transport infrastructure	ADB allocated a technical assistance grant of \$1.05 million to upgrade urban transport infrastructure in Baku.
Second Road Network Development Investment Programme – Tranche 1	250	Transport and transport infrastructure	The construction of a total of approximately 63 km of road sections on the new Masalli-Shorsulu road, comprising a approximately 30 km section between the cities of Masalli and Jalilabad and a approximately 33 km section between the cities of Jalilabad and Shorsulu.
Armenia			
Loan: Armenia Water Supply and Sanitation Project - Phase 2	40	Municipal and other infrastructure	The project intends to facilitate the rehabilitation of water supply networks across ten subprojects that will cover 17 towns and 92 villages. The project's total cost amounts to \$50 million (\$10 million to be provided by the government of Armenia).
Power Transmission Rehabilitation Project	0.7	Power industry	The project aims at improving power system operational efficiency and power supply reliability in Armenia. The project foresees the expansion of supervisory control and data acquisition (SCADA) system and the rehabilitation of eight existing substations.
Women's Entrepreneurship Development	0.406	Public administration	The programme comprises an integrated approach to enable female entrepreneurs in Armenia to play a greater role in economic development.
Infrastructure development programme	0.5	Public administration	The proposed technical assistance will support the government in updating the assessments for road and water sectors, and develop the financing options and strategy for public and private participation in road sector, etc.
Kazakhstan			
TA: CAREC Corridor 3 Rehabilitation Project	0.225	Transport and transport infrastructure	Technical assistance to help prepare for the CAREC Corridor 3 (Tashkent-Shymkent Road) Rehabilitation Project.
CAREC Corridor 3 (Shymkent-Tashkent Section)	125	Transport and transport infrastructure	The project will rehabilitate a 37-km road section in Kazakhstan, a part of the road connecting Tashkent (Uzbekistan), and Shymkent (Kazakhstan). The remaining portion will be financed by the EBRD in parallel. The project road will start from Shymkent, linking CAREC Corridors 1 and 3.

Project	Total (\$ million)	Sector	Note
Karaganda District Heating Network Rehabilitation Project	1	Energy efficiency	Technical assistance for Karaganda District Heating Network Rehabilitation Project in Karaganda region. The project foresees the rehabilitation of 7 pumping stations and replacement of 127 km of pipeline.
CAREC Corridor 2 Investment Programme – Tranche 2	371.3	Transport and transport infrastructure	Reconstruction of about 790 km of the road sections of the CAREC Corridor 2 in the Mangystau Oblast.
Kyrgyzstan			
Power Sector Rehabilitation Project	55	Energy efficiency and power industry	ADB allocates a \$40 million grant and a \$15 million loan to rehabilitate Toktogul hydropower plant (replacing existing mechanical and electrical equipment and conducting a safety assessment of dams on the Naryn cascade).
CAREC Corridor 3 (Bishkek–Osh Road) Improvement Project, Phase 4	1	Transport and transport infrastructure	A project preparatory technical assistance (PPTA) from the ADB to identify, formulate, and prepare an ensuing loan and/or grant for Bishkek–Osh Road Improvement Project. The PPTA will cover the candidate road sections of Bishkek to Kara-Balta (60 km) and Madaniyat to Jalalabad (70 km), and some feeder roads along the sections.
Implementing the e-Procurement System	1	Public administration	The technical assistance will support the development and rollout of the government e-procurement system.
Second Vocational Education and Skills Development Project	20	Social sector	The project seeks to improve the quality and relevance of the technical and vocational education and training system in the Kyrgyz Republic through modernisation of training methodology, teaching and learning environments, and training delivery. The project also includes support to rural primary vocational schools outside of Bishkek and Osh.
Investment Climate Improvement Programme – Subprogramme 2	20.55	Public administration	The grant aid will help the government to establish favourable conditions for investments.
Tajikistan			
TA: Roads Improvement Project	0.8	Transport and transport infrastructure	A grant to finance the feasibility study for the rehabilitation and reconstruction of the road between Ayni-Panjakent and the border with Uzbekistan, and the Sayron-Karamik road section.
TA: Building Capacity for Climate Resilience	6	Environment	This TA will enhance planning capacity for climate change adaptation at national and local levels.
CAREC Corridor 6 (Ayni-Panjakent Road)	100	Transport and transport infrastructure	CAREC Corridor 6 project will restore a 113-km road section between Ayni–Panjakent and the Uzbekistan border, as well as add an additional asphalt concrete layer to the 89-km Sayron-Karamik section.

Project	Total (\$ million)	Sector	Note
Uzbekistan			
CAREC Corridor 2 Road Investment Programme – Tranche 3	100	Transport and transport infrastructure	This component will finance civil works of about 40 km of the Uzbekistan Section of CAREC Corridor 2 Road (between Km 315 and Km 355 of A380 highway) and the improvement of cross-border facilities at Daut-ata.
Namangan 500-kV Power Transmission Project	150	Power industry	Construction of a 500 kV overhead transmission line of approximately 175 km between Novo Angren Thermal Power Plant (TPP) and Namangan Substation; rerouting of 220 kV overhead transmission lines of approximately 32 km between Kuzyl-Ravat-Sardor and Sardor-Crystal and Namangan Substation, and construction of 500 kV/220 kV Namangan Substation and reconstruction of outdoor switchgear 500 kV at the Novo Angren TPP.
Second Water Supply and Sanitation Investment Programme	0.8	Municipal and other infrastructure	The technical assistance will support the government's long-term water supply and sanitation (WSS) development programme, and improve living and health conditions of the populations in Namangan, Tashkent, Djizzak and Kashkadarya provinces.
Water Resources Management	1.5	Agribusiness	A project preparatory technical assistance grant provided from ADB's Technical Assistance Special Fund to prepare the loan project that will improve the water resources management and enhance agriculture productivity.
Strengthening Governance and Improving Local Government Capacity	0.68	Public administration	Technical assistance for the Government of Uzbekistan in preparing project documentation for the programme to reduce the disparities in living standards between residents of rural and urban areas.
Second CAREC Corridor 2 Road Investment Programme – Tranche 2	220	Transport and transport infrastructure	The reconstruction of 75 km of the section of A373/4P112 highway (between Km 0 and Km 75) from Pungan to Namangan. The investment will upgrade the existing two-lane section to a four-lane section. The cost includes civil works and construction supervision consulting services.
Insurance Sector Development	0.5	Financial sector	The technical assistance will undertake assessments to determine compliance with international insurance standards, including the Insurance Core Principles (ICPs) of International Association of Insurance Supervisors (IAIS), estimate market potential, and identify needs for capacity building.
E-Government for Effective Public Management	1.1	Public administration	The proposed technical assistance will help the Government of Uzbekistan accelerate its own e-government initiatives in four priority areas: property registration, business registration, public procurement and public access to information.
Takhiatash Power Plant	1.2	Energy efficiency and power industry	The proposed project preparatory technical assistance to prepare the Takhiatash Power Plant Efficiency Improvement Project.

ADB*Investment project financing:*

Project	Total (\$ million)	Sector	Note
<i>Uzbekistan</i>			
Private Sector: Surgil Natural Gas Chemicals	400	Oil and gas sector	The Surgil Natural Gas Chemicals Project developed and operated by Uz-Kor Gas Chemical LLC aims to build Uzbekistan's largest-ever petrochemical plant to produce gas for commercial use and for conversion into chemical intermediates used in the plastics and textiles industries. The total cost of the project is around \$4 billion. The project will be co-financed by other banks. The ADB is providing a 13-year loan of up to \$125 million and a 13-year commercial risk guarantee of up to \$275 million. The plant is expected to be operational early 2016.
Ipak Yuli Bank	6	Financial sector	ADB acquired approximately 15% of the issued capital of the Ipak Yuli Bank. The deal, ADB's first equity investment in a bank in Uzbekistan, was expected to be closed in Q1 2013.
<i>Kyrgyzstan</i>			
Kyrgyz Investment and Credit Bank	10	Financial sector	A senior \$10 million loan to Kyrgyz Investment and Credit Bank for the purpose of funding SMEs in the country.

ACF (EDB)*Sovereign loans and grants:*

Project	Total (\$ million)	Sector	Note
Stabilisation programme	880	Public administration	On June 4, 2011, the ACF Council approved a \$3 billion loan to the Republic of Belarus to support the country's stabilisation programme. The agreement foresees the allocation of several tranches over three years. Thus, the EDB, the ACF fund manager, disbursed two \$800 million and \$440 million tranches to Belarus in 2011, a third tranche of \$440 million on June 128, 2012 and a fourth tranche of \$440 million in December 2012.

EBRD*Investment project financing:*

Project	Total (\$ million)	Sector	Note
Azerbaijan			
Demirbank	7	Financial sector	The EBRD's 10-year loan will provide much-needed capital to Demirbank to increase lending capacity and support asset growth. Demirbank is a private commercial bank, 25% owned by the EBRD.
AccessBank	15	Financial sector	A five-year \$15 million senior loan will help AccessBank Azerbaijan in expanding its micro, small and medium-sized enterprise (MSME) lending portfolio in the regions outside of Baku with a particular focus on agricultural lending. In addition the provision of longer tenor financing will strengthen AccessBank's balance sheet and business model by improving the diversification and maturity of funding.
AccessBank	10	Financial sector	A five-year senior EBRD loan of up to \$10 million will help AccessBank Azerbaijan to expand its small enterprise lending portfolio in the regions outside of Baku with a particular focus on agricultural lending.
Armenia			
Ararat Bank	0.65	Financial sector	The EBRD is considering subscription to newly issued ordinary voting shares of OJSC Araratbank of approximately 250 million Armenian drams (\$650,000 equivalent) as part of Araratbank's capital increase of 1,000 million drams (\$2.6 million equivalent).
DIF – Lydian (Amulsar Gold Mine)	5.66	Mining and processing industry	Equity financing for a private mining company, Lydian International Limited (Amulsar Gold Mine), registered in Jersey and listed on the Toronto Stock Exchange.
JSC IEC hydropower rehabilitation	25	Energy and energy efficiency	Total project cost – \$50 million. Financing to JSC International Energy Corporation (IEC) to rehabilitate its existing hydropower plants. The Project would upgrade outdated equipment and improve the capacity, reliability and efficiency of the 7 hydropower plants which comprise the Sevan Hrazdan cascade.
Belarus			
IOOO Mebelain	6.31	Production and services	The borrower is IOOO Mebelain, which is controlled by Lithuania's SBA Furniture Group. The project's total cost is estimated at around €14 million. A seven-year €5 million loan to finance the building of a furniture plant in a fast-growing cluster on Belarus's border with Russia. The plant will use raw material supplied by the cluster's first project, a Lithuanian-owned wood processing plant.
BelSEFF	13.25	Energy and energy efficiency	The investment of €10 million will comprise credit lines to local banks for onward-lending to industrial companies and SME undertaking energy efficiency and renewable energy projects. The facility will be supported by a grant from the Czech ODA Trust Fund for technical assistance.

Project	Total (\$ million)	Sector	Note
Belgazprombank (SME)	30	Financial sector	Up to \$30 million senior loan for onward-lending to SME. The sub-loans will be onward-lent for up to five years and used for capital expenditures and working capital.
Belgazprombank	20	Financial sector	Up to \$10 million senior loan to SME for energy efficiency financing and an increase to the existing Trade Facilitation Programme facility of up to \$10 million.
Kazakhstan			
KazExportAstyk	45	Agribusiness	The EBRD's equity investment via subscription to the newly-issued share capital of KazExportAstyk worth \$45 million.
Aktau district heating system modernisation programme	7.57	Energy efficiency	The Aktau State Communal Enterprise "Heating, Water Networks and Wastewater", or TVS&V, will receive an EBRD loan of up to 1.2 billion Kazakh tenge (€6 million) and a loan of up to \$4.3 million (€3.2 million equivalent) from the Clean Technology Fund (CTF).
Kyrgyzstan			
Kara-Balta Water Rehabilitation Project	2.52	Municipal and other infrastructure	€2 million to Kara-Balta Water Company. The project's total funding amounts to €6.4 million, including technical cooperation. The project will be co-financed by an investment grant from an international donor.
KyrSEFF	20	Energy and energy efficiency	A new financing facility of up to \$20 million to support energy efficiency investments in the Kyrgyz Republic. The project will consist of credit lines to local banks and multilateral financial institutions for on-lending to private businesses, households, individuals, groups of residents, housing associations, condominiums and cooperatives as well as housing management companies and energy service companies for financing eligible energy efficiency investments.
Moldova			
Modernisation of energy infrastructure	20	Power industry	The EBRD is supporting the modernisation of Moldova's power sector with a \$20 million sovereign loan to benefit Moldelectrica, state-owned energy transmission company.
BCR Chisinau	3.79	Energy efficiency	A €3 credit line extended under Moldovan Residential Energy Efficiency Financing Facility (MoREEFF) to BCR Chisinau to finance residential energy efficiency projects in Moldova. The framework is complemented by grant funding by the Swedish International Development Cooperation (SIDA) worth €2.3 million as well as an EU NIF (Neighbourhood Investment Facility) grant of €5 million.
Balti Trolleybus Department	3.97	Transport and transport infrastructure	A loan of up to €3 million to the Municipal Enterprise "Balti Trolleybus Department" for the acquisition of up to 23 new trolleybuses and essential maintenance equipment. The project is expected to be cofinanced by the EU Neighbourhood Investment Facility via a capital investment grant of €1.6 million.

Project	Total (\$ million)	Sector	Note
ProCredit Bank	5	Energy and energy efficiency	A \$5 million loan to ProCredit Bank Moldova is part of the EBRD's second Moldovan Sustainable Energy Financing Facility (MoSEFF II). The funds will be used for onward-lending to finance energy efficiency and small renewable energy investments undertaken by small and medium-sized enterprises, agribusiness and commercial services. MoSEFF II is complemented by grant support of €6.8 million, provided by the European Union, which will be used for technical assistance and investment incentives.
Danube Logistics - Giurgiulesti Port	12	Transport and transport infrastructure	Giurgiulesti International Free Port, the only port in Moldova, is owned and operated by Danube Logistics SRL. The project's total cost is \$30.7 million. The EBRD senior loan will part finance the completion of the port infrastructure and in particular the construction of the mixed-gauge rail terminal and roll-on-roll-off ramp.
<i>Russia</i>			
Technopark Pulkovo Phase II	21.71	Transport and transport infrastructure	A senior loan of €24.7 million comprising an A-Loan of €17.2 million from the EBRD's own account and a B-Loan of €7.5 million to be syndicated to commercial banks. The Project's total cost is €49.3 million.
MICEX-RTS	not specified	Financial sector	The acquisition of a 6.29% equity stake in MICEX-RTS through a purchase of ordinary voting shares.
SVL Group	20.1	Transport and transport infrastructure	Senior loan of up to \$20.1 million to finance part of the cost of three new-built double-hull sea-river tankers, to be acquired by SVL Group. The EBRD financing will be complemented by a parallel loan from ZAO Unicredit Moscow.
Modern heating systems	94.68	Municipal and other infrastructure	A 16-year loan of up to 3 billion roubles (€75 million) to finance the replacement of both heat-generating facilities and heat-distribution systems in the ports of Tiski and Cherskyi in the Republic of Sakha (Yakutia).
Katren group	not specified	Municipal and other infrastructure	A minority equity stake of around 15% in OJSC Katren, the third largest pharmaceutical distributor in Russia. Other financial details of this transaction were not disclosed.
EBRD arranges financing for Russian car plant in Kaluga	138.86	Transport and transport infrastructure	The EBRD and a syndicate of commercial banks agreed to lend €320 million to a joint venture formed by France's Peugeot-Citroen and Japan's Mitsubishi Motors Corporation to fund the production of passenger cars in their Kaluga plant in Russia. The facility consists of an EBRD seven-year A-Loan of €110 million and a five-year B-Loan of €150 million syndicated to a group of international banks.
Green hypermarkets in Russia	148.33	Agribusiness	A 10-year rouble equivalent of a €117.5 million loan to OOO Hyperglobus to partially finance the construction of four hypermarkets in Korolev and Krasnogorsk and later in Tver and Zelenograd. The remainder of the financing for the group's investment programme will be attracted on a parallel basis.

Project	Total (\$ million)	Sector	Note
Modernisation of Syzran sanitary ware plant	44.82	Production and services	Long-term financing of up to €35.5 million, of which up to €7 million denominated in roubles, to support the modernisation and expansion of a sanitary-ware plant for a group of companies (Glemarco, Pilkington's East and the plant, Syzranskaya Keramika). The EBRD will lend €23 million from its own account and arrange the remaining €12.5 million to be provided by other lenders.
Private medlabs chain KDL	not specified	Production and services	Two Russia-focused private equity groups, UFG Private Equity and CapMan, are joining forces with the EBRD to buy into KDL, Russia's third largest chain of private laboratories for medical testing. After the initial investment round, the three investors will have a total shareholding of 75%, distributed as follows: UFG 40.3%, CapMan 24% and EBRD 10.7%. Further commercial terms of the deal are not being disclosed. It represents the first investment in the health sector for all three participants.
Belaya Dacha	10	Agribusiness	An acquisition of a 9.91% stake in the share capital of ZAO Belaya Dacha Trading, the leading producer of fresh-cut, ready-to-eat packaged salads. The funding of \$10 million will be used to finance the construction of a processing plant in southern Russia.
Western High Speed Diameter	252.48	Transport and transport infrastructure	The EBRD committed to a loan of up to €200 million to fund a section of a new toll road, the Western High Speed Diameter, by-passing the historic centre of St. Petersburg. It thus joined four other banks in raising a total of nearly 59 billion roubles (equivalent to €1.5 billion).
Belaya Dacha	10	Agribusiness	A \$10 million loan to a Moscow fresh salad producer, ZAO Belaya Dacha LTD, which will help the company build a new plant near St Petersburg and develop salad production in central and southern Russia.
Globaltrans	77.4	Transport and transport infrastructure	A 2.5 billion rouble (equivalent to €60 million) loan to Globaltrans for modernisation of the Russian freight rail industry.
Inter RAO UES	309.6	Energy and energy efficiency	The EBRD provided a five-year convertible loan of 9.6 billion roubles (equivalent to around €240 million) to Russia's Inter RAO UES to help prepare the energy holding for a potential international public offering.
ZAO Raiffeisenbank	50	Financial sector	EBRD committed up to \$50 million through a structured debt instrument to ZAO Raiffeisenbank. The transaction saw the Bank invest in seven-year bonds indirectly secured by pledges of ZAO Raiffeisenbank's current and future US dollar and euro receivables, known as Diversified Payment Rights (DPRs). The financing is complemented with the IFC investment of \$75 million. The funding will allow ZAO Raiffeisenbank to expand finance to small and medium enterprises, and municipalities.
CBM	95.5	Financial sector	The EBRD acquired 7.5% of newly issued ordinary and voting shares of Credit Bank of Moscow (CBM) for 2.9 billion roubles (€74 million). The funding will be used to strengthen the capital of Russia's bank. IFC is also purchasing a 7.5% stake in CBM.

Project	Total (\$ million)	Sector	Note
Elbrus Capital Fund II	50	Financial sector	The EBRD will invest up to \$50 million in Elbrus Capital Fund II that aims to make equity investments in the regions of Russia, as well as other CIS countries, focusing on small and medium-sized companies in order to expand their access to long-term financing.
Russia's Prognoz group	30	Telecommunications sector	An EBRD 6-year convertible loan of \$30 million for Russia's Prognoz group, the leading Russian software developer for business intelligence (BI) applications, will help this fast-growing niche player expand in global markets.
Trivon - Equity (Virgin Connect)	30.5	Telecommunications sector	Total project cost is estimated at \$131 million. The IFC proposed equity investment will amount to \$25 million, EBRD - \$30.5 million equity. The investments will mostly be used for network optimisation of current operations, and for partial funding of the Company's expected acquisitions (small broadband operators in Russia).
Vladivostok TPP	132.45	Energy and energy efficiency	The EBRD is financing a new 140MW gas fired Combined Heat power plant to replace an existing coal fired heating facility in Vladivostok city. The loan will be provided to JSC RAO ES of East and part of it will be used to refinance existing debt. Senior loan of up to 4 billion roubles (€100 million) is envisaged for the project. It is expected that the project will be co-financed by the EIB. The Project's total operation cost is estimated at 10.3 billion roubles (€250 million).
RSBF - Orient Express Bank- Loan III	55.31	Financial sector	A loan to Orient Express Bank (OEB) under EBRD's Russia Small Business Fund (RSBF) micro and small enterprise (MSE) lending programme. Senior loan of 1.68 billion roubles from EBRD, with another 0.02 billion roubles co-financed by the Russia Small Business Investment Special Fund. The overall maturity of the loan is three years. Total project cost amounts to 1.7 billion roubles.
Rosbank Syndicated Loan	50	Financial sector	A senior syndicated loan to Rosbank in the aggregate amount of up to \$150 million for SME lending and general corporate purposes (incl. trade finance transactions). The A/B structure includes A portion for the account of EBRD of up to \$50 million and B portion of up to \$100 million for the account of commercial participants in the international market.
Brunswick Rail	25	Transport and transport infrastructure	The EBRD participated in Brunswick Rail's \$600 million Eurobond debut with an amount of \$25 million. The proceeds of the Eurobond will mainly be used for repaying any outstanding amounts under the existing EBRD and IFC loan facilities and for the acquisition of rolling stock.

Project	Total (\$ million)	Sector	Note
Tajikistan			
Eskhata Bank	3	Financial sector	Eskhata Bank joined the EBRD's Medium Sized Co-Financing Facility (MCFF) programme and will receive up to \$3 million in loan and risk sharing financing. The new programme will assist Eskhata Bank in meeting the financial needs of its growing small and medium-sized borrowers by sharing risk exposure and co-financing Eskhata's best clients with the EBRD.
Ukraine			
Agrotrade	28.00	Agribusiness	A financing package worth up to \$28 million to Agrotrade Group of Ukraine to finance the company's working capital and the expansion of grain handling facilities. The project's total cost is \$34 million.
ZhytomyrTeploKomunEnergo	12.62	Municipal and other infrastructure	A ten-year €10 million loan to the Municipal District Heating Company "ZhytomyrTeploKomunEnergo", to finance the reduction of energy losses, gas and electricity consumption and improvement of the quality of service of the heat and hot-water supply system in the City of Zhytomyr. The loan will finance the rehabilitation and modernisation of existing boiler houses, replacement of pipes, and introduction of new, compact individual heating sub-stations. The EBRD loan will be expanded with a €5 million grant from the Eastern Europe Energy Efficiency and Environment Partnership (E5P) Fund, which will allow the financing of the installation of a bio-fuel boiler, which will use waste from the local timber-processing industry.
UkrEximBank	50	Energy efficiency	A \$50 million five-year loan to the State Export-Import Bank of Ukraine (UkrEximBank) for onward-lending to SMEs in the amount of up to \$3 million to implement energy efficiency projects.
Yugrefttransflot	10	Transport and transport infrastructure	A long-term \$10 million senior loan to Ukrainian shipping company JSC Yugrefttransflot of Ukraine to finance part of the acquisition cost of two multi-purpose dry cargo vessels.
First wind power project in Ukraine	11.99	Power industry	The EBRD is making its first ever investment into wind power generation in Ukraine by organising a €13.3 million financing package to Eco-Optima, a Ukrainian-Italian joint venture company, which will operate a wind farm in Staryy Sambir region of western Ukraine. The loan will consist of two parallel tranches: a 10-year EBRD loan of €9.5 million and a 15-year loan of €3.8 million from the Clean Technology Fund (CTF).
Hotel Leipzig	37.87	Infrastructure	A \$30 million loan to Grand Plaza, a special purpose company incorporated in Ukraine, for the redevelopment of the historic Leipzig hotel in the heart of Kiev to be managed by the leading international chain, Marriott Renaissance.

Project	Total (\$ million)	Sector	Note
Agrotrade Group	23	Agribusiness	A financing package worth up to \$23 million to Agrotrade Group of Ukraine, including a working capital loan of up to \$15 million and a senior loan of up to \$8 million to finance energy efficiency measures and the expansion of grain handling facilities.
Crimea Municipal Infrastructure Project	12.62	Municipal and other infrastructure	A loan of up to €10 million to the Production Enterprise of Water and Wastewater Management Utility of the South Coast of Crimea will help to modernise municipal water treatment facilities and water distribution networks, construct clean water reservoirs, replace old pumps and also modernise and upgrade the wastewater network. The project is co-financed by the Swedish International Development Cooperation Agency (SIDA), which is providing a grant of up to €5 million.
ACTI Ukraine	50	Agribusiness	The EBRD provided a \$50 million revolving loan facility to Alfred C. Toepfer (Ukraine) Ltd (ACTI Ukraine) to finance the company's working capital needs associated with production of agricultural commodities in Ukraine.
Agrofusion	20	Agribusiness	\$20 million in debt financing to Agrofusion, with the goal of funding its capital expenditure, medium-term working capital as well as restructuring its balance sheet.
Construction of a bio-gas plant at Ukraine's Astarta	12	Agribusiness	A loan to one of Ukraine's major agribusiness groups, Astarta, will help increase the use of renewable energy at its key sugar plant. A senior loan of up to \$12 million to Astarta's subsidiary LLC APO "Tsukrovkyk Poltavshchyn" will be provided under the EBRD's Agribusiness Sustainable Investment Facility.
Ternopil District Heating Modernisation	12.9	Energy and energy efficiency	An EBRD €10 million loan to the municipal district heating utility operating in the City of Ternopil for a project aimed at improving the energy efficiency, reducing energy losses, gas and electricity consumption and improving the quality of heat and hot water supply services. The project is expected to be co-financed by an up to €5 million grant from the E5P.
Nibulon Group	30	Agribusiness	A syndicated facility of up to \$130 million, including up to \$30 million for the EBRD's own account and a loan of up to \$100 million, syndicated to commercial banks. The project's total cost amounts to approximately \$447.8 million. Nibulon plans to revive navigation on key rivers in Ukraine, as well as to develop grain market infrastructure.
Multi Development Forum Lviv	67.21	Municipal and other infrastructure	The EBRD provided a senior loan of €46.1 million to the Netherlands company, Multi Corporation B.V. Part of the loan is syndicated to commercial banks. Another €6.0 million – a subordinated loan. The funds will be used for the development and operation of a modern inner-city shopping mall, located in Lviv, Ukraine. The borrower is Multi Veste Ukraine 3 ZAT LLC, controlled by Multi Corporation B.V. The project's total cost is estimated at approximately €90 million.

Project	Total (\$ million)	Sector	Note
ED&F Man (equity investment)	15.9	Agribusiness	An equity investment of up to \$15.9 million in ED&F Man Ukraine Investments BV, to acquire a minority stake in the company and finance the purchase and installation of sugar beet processing equipment. The total cost of the project is \$69 million.
IZ	25	Agribusiness	Up to \$25 million debt financing to Inter Group to support the upgrades and expansion of the existing production facilities, the construction of a premises plant and the restructuring of the balance sheet. The project's total cost is \$43 million.
Coal Energy	70	Energy and energy efficiency	A corporate loan of \$70 million to Coal Energy S.A., a Luxembourg-based holding of a Ukrainian coal-mining group, to finance the implementation of energy efficiency programmes at priority mines.
UNPK Rail Ukraine	7	Transport and transport infrastructure	A senior loan of up to \$7 million to finance the railcar acquisition programme of the Ukrainian New Forwarding Company (UNPK), the Ukrainian subsidiary of Globaltrans Investment Plc. The project costs \$33 million.

EBRD

Sovereign loans and grants:

Project	Total (\$ million)	Sector	Note
Armenia			
Yerevan metro	6.45	Transport and transport infrastructure	The EBRD has teamed up with the EIB to provide a sovereign loan of €10 million (€5 million each) co-financed by an investment grant from the EU's Neighbourhood Investment Facility (NIF) of the same amount. This project is Phase II of the Yerevan metro rehabilitation project.
Northern Corridor Modernisation Project	13.64	Transport and transport infrastructure	A sovereign loan of up to €10.3 million. It is expected that the EIB, EU, Neighbourhood Investment Facility and UNDP, jointly with the government of Armenia, will finance this project, the total cost of which is €62.6 million. The financing is aimed at modernisation and upgrade of transport infrastructure including three Border Control Points, Bagratashen, Bavra and Gogavan, along the Armenian border with Georgia.
Kazakhstan			
Shymkent-Tashkent road reconstruction project	197	Transport and transport infrastructure	A sovereign loan of up to \$197 million for reconstruction and upgrading of the road section (62 km) connecting the city of Shymkent and the Uzbek border. The remaining road section (37 km) will be financed by ADB. The project is part of the upgrading the South-West international transport corridor linking Europe with China (CAREC). A total estimated cost of the projects is \$378.2 million.

Project	Total (\$ million)	Sector	Note
Almaty Bus Sector Reform Phase 2	39.3	Environment	A senior loan of up to \$39.3 million (€30.2 million) to Almatyelectrotrans, a municipal urban transport company currently operating trams, trolleybuses and buses in Almaty. The project's cost is equal to 8.5 billion tenge (€43.3 million). The loan proceeds will be used to procure up to 200 new compressed natural gas buses and a gas filling station, as well as the development of contractual structure necessary for inclusion of private operators.
Zhanros Group	22.5	Environment	The Zhanros Group is an oil field services group established in Kazakhstan providing integrated drilling services and other maintenance services to oil & gas companies. The EBRD provides debt financing of up to \$22.5 million for acquisition of a hydraulic fracturing unit, and two drilling rigs for drilling works to be used in the western regions of Kazakhstan.
Kyrgyzstan			
Kara-Balta water system modernisation	8.13	Municipal and other infrastructure	The project's total funding amounts to €6.3 million, including grant funds of €3 million from the EBRD Shareholder Special Fund, an additional grant of €1.3 million from the EBRD to support project implementation and to provide technical assistance, and a loan of €2 million. With the Bank's support the Kara-Balta Water Company will carry out significant rehabilitation and modernisation of water and wastewater networks.
Tajikistan			
Khatlon Water Rehabilitation Project	7	Municipal and other infrastructure	The EBRD will provide a sovereign guaranteed loan to the State Unitary Enterprise Khojagii Manziliyu-Kommunali (KMK) in an amount of up to \$7 million to improve the municipal water services in the cities of Isaev and Yovon in the Khatlon province. The project's cost is up to \$15 million including investment and technical cooperation grants. The project will be co-financed by an investment grant from an international donor (IFCA grant of \$7 million).
North Tajik Water Rehabilitation II Project	7	Municipal and other infrastructure	A programme of priority capital investments to rehabilitate the water supply systems in the North Tajik cities of Istravshan, Panzhakent, Shakhriston and Zafarobod. The EBRD will provide a sovereign guaranteed loan to the State Unitary Enterprise Khojagii Manziliyu-Kommunali (KMK) in an amount of \$7 million. The project cost is \$16 million including related technical cooperation. The project will be co-financed by an investment grant from an international donor (SECO \$8.5 million).
CAREC Corridor 3	35	Transport and transport infrastructure	Part of the CAREC Corridor 3 to be upgraded thanks to investment from the EBRD and the ADB. The EBRD is providing a sovereign loan of \$35 million to finance the urban section of the road within the capital. The ADB is providing grant financing for the inter-urban sections of the 62-km road. EBRD's Early Transition Countries Fund and the Slovak fund are also assisting with technical cooperation for the project.

Project	Total (\$ million)	Sector	Note
Ukraine			
Modernisation of Ukraine's gas transportation system	308	Power industry	The EBRD and the EIB are currently working on the preparation of a \$308 million loan focused on emergency repairs to the main Urengoy-Pomary-Uzhhorod export pipeline, urgently required for safe and uninterrupted gas transit to Europe. This loan can be available by the end of 2012.
Dnipropetrovsk Metro Construction Completion Project	196.1	Transport and transport infrastructure	A senior loan of €152 million to the Dnipropetrovsk Metro Company, expected to be co-financed in equal proportion by an EIB loan. The project will finance the completion of the existing metro line, which will now link the suburbs with the city centre. A grant of over €900,000 will be available from the EU's Neighbourhood Investment Facility (NIF).

EDB

Investment project financing:

Project	Total (\$ million)	Sector	Note
Armenia			
Araratbank	4	Financial sector	A loan to Araratbank to finance micro and small enterprises
Areximbank	10	Financial sector	A loan to Areximbank to finance trade and energy efficiency projects
VTB Bank (Armenia)	15	Financial sector	A loan to VTB Bank (Armenia) for onward-lending to SMEs.
Belarus			
Belgazprombank	20	Financial sector	A loan to Belgazprombank to finance foreign trade transactions. Credit facility increase.
Mospromstroy-Hotel	47	Municipal and other infrastructure	A loan to Mospromstroy-Hotel (Mospromstroy subsidiary) for the construction of a hotel complex in Minsk by a Russian investor. The hotel will provide four-star services under the Renaissance brand.
Kazakhstan			
Batys Transit	21	Power industry	A loan facility to secure a full load of the North Kazakhstan-Aktobe Region transmission line by linking a new major power consumer, a new production facility at the Aktobe ferroalloy plant.
KazExportAstykh Holding (bond placement)	2	Agribusiness	KazExportAstykh Holding placed a new issue of bonds within the framework of its third bond placement for a total amount of 40 billion tenge. The bonds carry an 8.5% semi-annual coupon and mature in 2016. The EDB acted as joint manager of the transaction.
Agribusiness-Invest-3 Corporation	15	Agribusiness	An increase to a credit facility that will be used to finance export operations.

Project	Total (\$ million)	Sector	Note
Karatau LLC	50	Mining and processing industry	A loan to finance the company's investment programme.
Yeskene Railcar Service Centre LLC	56	Transport and transport infrastructure	Construction of a rolling stock repair complex and a washing and steaming station in Kazakhstan
Eurasian Bank JSC	7	Financial sector	A five-year renewable trade finance loan facility to Eurasian Bank (Kazakhstan). This is EDB's first project in Kazakhstan to be implemented within the framework of the EDB Trade Finance Programme. The funds will be used to finance foreign trade transactions of this commercial bank's clients in the EDB member states. Financing may be provided in different currencies.
KazAgroFinance	10	Financial sector	A guarantee to secure KazAgroFinance's performance of obligations to Deere Credit Inc.
Electrovoz Kurastyru Zauyty LLC	67	Transport and transport infrastructure	The setup of production of electric locomotives in Kazakhstan
Russia			
Gaztechleasing	15	Transport and transport infrastructure	A tender participation guarantee to Gaztechleasing.
RAIL1520	75	Transport and transport infrastructure	A ten-year \$75 million credit facility to RAIL1520 to finance the freight transportation market development project.
Centre-Invest Bank	5	Financial sector	A non-revolving 3-year credit facility of 150 million roubles to Russia's Centre-Invest Bank to finance SME in Russia.
Centre-Invest Bank	5	Financial sector	A non-revolving 3-year credit facility of 150 million roubles to Russia's Centre-Invest Bank to finance energy efficiency projects in Russia.
LLC Northern Capital Highway	328	Transport and transport infrastructure	The EDB increased its participation in the PPP project to construct and operate the Western High Speed Diameter (WHSD) toll road in St. Petersburg to 10 billion roubles.
NBD-Bank	5	Financial sector	A credit facility to NBD-Bank for onward-lending to SMEs.
RosEvroBank	7	Financial sector	A two-year revolving loan facility to RosEvroBank for a total of \$7 million to finance foreign trade transactions of the Bank's clients in the EDB member states. Financing is available in roubles, euro, US dollars, or in currencies of the CIS countries.

Project	Total (\$ million)	Sector	Note
OJSC Yenisei TGC (TGC-13)	295	Energy efficiency and power sector	Financing of OJSC Yenisei Territorial Generating Company (TGC-13) investment programme, including the construction of a new power unit at the Abakan CHP.
Verkhnekamsk Potash Company	99	Chemistry, petrochemistry and mineral fertilizers	Acron Group invited Russian and international investors to participate in its project to develop the Talitsky area of the Verkhnekamsk potassium-magnesium salts deposit in Perm Krai, which is being implemented by Verkhnekamsk Potash Company (VPC). The project foresees the construction and commissioning of the Talitsky mining and processing integrated works. The project finance structure involves both equity and debt financing.
Polymetal	100	Mining and processing industry	A non-revolving loan facility agreement to finance the design and development of infrastructure for the company's mining projects.
Centre-invest Bank	5	Financial sector	Energy efficiency. Credit facility increase.

EIB

Investment project financing:

Project	Total (\$ million)	Sector	Note
Moldova			
Moldelectrica	21.46	Power industry	A €17 million loan to finance the rehabilitation and modernisation of a part of the high voltage transmission network of Moldelectrica.
Chisinau Urban Roads	13.29	Transport	The reconstruction of six major streets with a total length of 14.3 km in the centre of Chisinau.
Russia			
Continental Tyre Plant Kaluga	79.47	Transport and transport infrastructure	Construction of a greenfield tyre production facility in Kaluga to manufacture tyres for passenger cars and light trucks. The project's total cost is estimated at €234 million, EIB investment – €60 million.
Nurminen Logistics Project	29.7	Transport and transport infrastructure	The project consists of the acquisition of 700 new freight wagons by the Russian subsidiary of Nurminen Logistics. The project's total cost is €51 million, EIB investment – €23 million.
Ukraine			
Hydropower Plants Rehabilitation	258	Power industry	Modernisation and upgrade of 21 Ukrhydroenergo's conventional and pumped storage hydropower plant units at six power stations along the River Dnieper in central Ukraine.
UniCredit Bank	185.43	Financial sector	Financing of small and medium scale projects promoted by SMEs via UniCredit Bank
Prominvestbank	264.9	Financial sector	Financing of small and medium scale projects promoted by SMEs via Prominvestbank
Ukreksimbank	132.45	Financial sector	Financing of small and medium scale projects promoted by SMEs via Ukreksimbank

EIB*Sovereign loans and grants:*

Project	Total (\$ million)	Sector	Note
Armenia			
Armenia Water Sector Project	8.39	Municipal and other infrastructure	The loan of €6.5 million will finance the improvement of the drinking water supply and wastewater treatment for some 300,000 inhabitants of 17 smaller towns in Armenia.
Yerevan metro	6.45	Transport	The EBRD has teamed up with the EIB to provide a sovereign loan of €10 million (€5 million each) co-financed by an investment grant from the EU's Neighbourhood Investment Facility (NIF) of the same amount. This project is Phase II of the Yerevan metro rehabilitation project. Phase I has also been financed by the EBRD, EIB and NIF, with a total of €15 million committed in 2010 to improve safety, sustainability and energy efficiency of the metro.
Improvement of transport links between Armenia and Georgia	39.11	Transport and transport infrastructure	A loan of €30.3 million will support the development of the border crossings points in Bagratashen, Bavra and Gogavan and the improvement of the access roads in their vicinity and associated infrastructure, including a new bridge at Bagratashen and the reconstruction of the 7.4 km main road leading to the Gogavan crossing. The project will contribute to the improvement of transport links between Armenia and Georgia.
Russia			
VEB Loan for SMEs and Mid-caps	264.9	Financial sector	EIB is lending €200 million to Vnesheconombank (VEB) to provide long-term financing for projects promoted by SMEs and mid-caps in Russia. The EIB funds will co-finance projects fostering the development of the private sector, improving social and economic infrastructure and addressing climate change mitigation and adaptation.
Ukraine			
Hydro Power Plants Rehabilitation	258.02	Power industry	Modernisation and upgrade of 21 Ukrhydroenergo's conventional and pumped storage hydropower plant units at six power stations along the River Dnieper in central Ukraine.
Dnipropetrovsk Metro Completion	196.1	Transport and transport infrastructure	A €152 million loan to finance the project for extending the existing metro line in Dnipropetrovsk by 4 km and adding 3 stations. The project's total cost is €305 million.

IsDB

Sovereign loans and grants:

Project	Total (\$ million)	Sector	Note
Kyrgyzstan			
Development of villages in Kyrgyzstan	0.095	Social sector	A \$95,000 Technical Assistance grant for Sustainable Villages Project in Kyrgyz Republic.
Taraz-Talas Suusamyr Road – Phase III	10	Transport and transport infrastructure	\$10 million for reconstruction of the Taraz-Talas Suusamyr Road – Phase III
Sustainable villages programme (ISFD)	6	Public administration	\$6 million from the ISFD for Sustainable Villages Programme in Kyrgyzstan.
Russia			
Grants for education programmes	not specified	Education	IsDB approved around \$425 million to finance development projects in member countries and for Muslim communities in non-member countries, including grants under the IsDB Waqf Fund, in contribution to the financing of education projects for Muslim communities in five non-member countries (Kenya, Russia, Bosnia, Burundi and the United States of America).
Tajikistan			
Secondary Schools Development Project	17.5	Municipal and other infrastructure	A \$17.5 million loan to Tajikistan to finance secondary schools development.
Construction of small hydropower plants in rural areas of Tajikistan	2	Power industry	IsDB approved allocation of an additional \$2 million in financing for construction of small electric power plants in rural areas in Tajikistan, thus increasing total funding for the project from \$9.2 million allocated earlier to \$11.2 million.
Uzbekistan			
Oncology Services	37.3	Health	A loan to the Uzbek government for the project to modernise the country's oncological institutions, including the acquisition of intra-caviatary and remote radiotherapy equipment for the oncological clinics. The loan will be disbursed over a 20-year period.
Modernisation of hydropower plants	100	Power industry	The Board of Executive Directors of IsDB approved a \$100 million loan to finance the project for the modernisation and expansion of hydropower plants in Uzbekistan.
Modernisation of Irrigation Systems	60	Municipal and other infrastructure	IsDB approved a loan of \$60 million for the modernisation of irrigation canals of Tashsakinsk system in the Khorezm region (north-west). The IsDB loan will be granted for a term of 20 years, including a four-year grace period under Istisna'a, which are non-interest futures, including the bank's commission. The project worth \$90.3 million provides an uninterrupted supply of water to irrigated land with total area of 26,000 hectares.

IsDB*Investment project financing:*

Project	Total (\$ million)	Sector	Note
<i>Uzbekistan</i>			
Ipak Yuli Bank	5	Financial sector	The Islamic Corporation for the Development of the Private Sector (ICD), the private sector arm of the IsDB Group signed additional Line of Financing agreement with Uzbekistan's Ipak Yuli Bank for a \$5 million facility.
Uzbek Industrial and Construction Bank	6	Financial sector	The Islamic Corporation for the Development of the Private Sector (ICD), the private sector arm of the IsDB Group signed additional Line of Financing agreement with Uzbekistan's Uzbek Industrial and Construction Bank for a \$6 million facility.

IFC*Investment project financing:*

Project	Total (\$ million)	Sector	Note
<i>Azerbaijan</i>			
AccessBank MSME	15	Financial sector	The project will support Accessbank in onward-lending to Azerbaijan's SME. A senior loan of up to \$15.
<i>Armenia</i>			
Byblos Arm REE	10	Financial sector	A long-term senior loan of up to \$10 million to Byblos Bank Armenia to support its loan programme for housing finance with particular emphasis on financing energy efficiency (EE) upgrades for households in Armenia.
HSBCbank Armenia	30	Energy efficiency	A financial facility to HSBC Bank Armenia to finance projects for investment in renewable energy and energy efficiency technologies in Armenia. IFC is considering supporting the project with financing from the Canada Climate Change Programme, a donor-funded facility for climate change friendly projects.
<i>Belarus</i>			
Alutech Expan	56.81	Production and services	IFC provided a €25m loan from its own account and mobilised a further €20m from Priobank to support Belarusian aluminium manufacturer Alutech Group in its expansion of production capacities. The project's total cost is estimated at €90 million.

Project	Total (\$ million)	Sector	Note
Kazakhstan			
MicroCredit Organisation Arnur Credit LLP	3	Financial sector	A senior loan of up to \$3 million equivalent to Microcredit Organisation Arnur Credit LLP, one of the leading commercial microfinance institutions in Kazakhstan. Proceeds of the loan will be used to finance the expansion of the Company's lending activities to micro and small entrepreneurs. Arnur Credit provides a range of products to its clients with rural loans for agricultural purposes. Arnur's average loan size is about \$2,000.
Kyrgyzstan			
Kompanion	6	Financial sector	A \$6 million senior loan to Kompanion Financial Group Microfinance CJSC to expand lending to micro and small entrepreneurs.
Moldova			
Trans-Oil	55	Agribusiness	A \$55 million investment from IFC's own resources and \$15 million syndicated by other banks. The Project's total cost is \$110 million. The Trans-Oil group of companies, a leading integrated agro-industrial group focused on grain origination trading and oilseed crushing in Moldova, is seeking financing to support its capital expenditure programme, including capacity expansion, energy efficiency investments and environmental upgrades; acquisition of five additional elevators and an 88.9% stake in Moldova's leading oilseed processor, Floarea Soarelui; and refinancing of short term debt to strengthen its capital structure.
Russia			
IXcellerate	40	Telecommunications sector	An acquisition of a 20% equity stake in datacentre operator IXcellerate Ltd. through a purchase of redeemable convertible preferred shares for a total of \$15 million and a long-term loan of \$25 million, consisting of a \$15 million A-Loan of and a \$10 million B-Loan. The total project will cost an estimated \$55 million.
NBD SME Frontier	34	Financial sector	The project's total cost is estimated at 1 billion roubles. IFC's investment consists of a senior local currency loan of up to 500 million Russian roubles up to 5 years to NBD Bank to finance SMEs in frontier regions of the Central part of Russia.
Kalmykia Roads	8	Transport and transport infrastructure	A 7-year 250 million roubles (\$8 million equivalent) senior loan with a two-year grace period to finance the rehabilitation of core road network in Kamykia.
CBM Equity 2	100	Financial sector	A direct equity investment of up to 2.9 billion roubles in Credit Bank OF Moscow (CBM) to strengthen the capital of the bank in view of its regional expansion and its preparation for an initial public offering (IPO) in the mid-term.

Project	Total (\$ million)	Sector	Note
Primorsky	14	Health	The proposed IFC investment will be in the form of an equity investment in OOO AVA-Peter of up to \$14 million to finance the construction of a greenfield multi-functional clinic comprising a diagnostic centre and a 96-bed general hospital in St. Petersburg. The Project is expected to cost \$34 million.
Virgin Connect	25	Telecommunications sectors	IFC's proposed equity investment in Trivon AG will make up to \$25 million. The investments will mostly be used for network optimisation of current operations, and for partial funding of the Company's expected acquisitions (of small broadband operators in Russia). Total project cost is estimated at \$131 million.
RBRU DPR	75	Financial sector	IFC to invest up to \$75 million (up to 7 years) in ZAO Raiffeisenbank's Diversified Payment Rights (DPR) securitisation. The proceeds from IFC's investment would be directed towards onward-lending to subnational entities to support their investment in the essential economic and social infrastructure, and SMEs.
BRL Club Deal	100	Transport and transport infrastructure	The borrower, Brunswick Rail Holding Limited, a leasing company providing freight rolling stock to corporate clients in the Russian Federation, is looking to expand its fleet. The proposed IFC investment will consist of a \$100 million A-Loan and a B-Loan for a total of up to \$150-\$200 million depending on the A-Loan conditions. The total cost of the project makes up \$250 million.
Rusfinance EECar	50	Financial sector	The proposed project is to provide up to \$50 million IFC A-Loan and, depending on market conditions, up to \$50 million IFC B-Loan to Rusfinance Bank LLC. The loan is intended to help Rusfinance launch its "Green Car" lending product for environmentally friendly vehicles. Total project cost is estimated at \$100 million.
Russian Towers	20	Telecommunications sectors	The project involves an equity investment by IFC of up to \$20 million to Russian Towers (owned by Setcar Holdings Ltd.) to support its plan to build a nationwide network of towers and lease the tower space to the Russian mobile phone operators. The project's total cost is \$300 million.
Forus Loan II	5	Financial sector	A \$5 million straight senior loan to Forus Bank to support the Bank's micro-lending operations in the European part of Russia.
Chuvashia 2012	33	Social sector	The proposed investment would support the implementation of the Chuvashia's capital expenditure programme in the pre-school education sector 2012-2014, which includes construction and reconstruction of pre-school education facilities (kindergartens) in major cities and smaller settlements. Total project cost is estimated at 3.173 million roubles (\$105 million equivalent). IFC investment – a 1 billion roubles (\$33 million) senior loan for a term of 10 years with a two-year grace period.
CPLF - KuAz	10	Energy efficiency	The proposed investment would support KuibyshevAzot OJSC in implementation of its energy efficiency and cleaner production programme. The total project cost makes up \$54 million, IFC investment – a \$10 million senior loan.

Project	Total (\$ million)	Sector	Note
Credit Bank of Moscow (CBM)	95.47	Financial sector	IFC acquired a 7.5% of newly-issued ordinary and voting shares of Credit Bank of Moscow (CBM) for €74 million. The funding will be used to strengthen the capital of the bank. The acquisition of shares is being made in conjunction and on parallel terms with the EBRD (€74 million).
ATB A + B SME Loan	60	Financial sector	An A-Loan denominated in Russian roubles from IFC's own account of up to \$30 million for up to five years, and a B/parallel-Loan of up to \$30 million to ATB to support the Bank's onward-lending to small and medium enterprises.
Elbrus Capital Fund II	20	Financial sector	An equity investment of up to \$20 million to Elbrus Capital Fund II LP, a closed-end private equity fund that will make investments in mid-sized private Russian enterprises. The Fund's target size is \$500 million.
OEB Syndication	90	Financial sector	A 5-year A-Loan of up to \$35 million equivalent, and a one-year B-Loan of approximately \$40 million equivalent, and possibly also an Agented Parallel Loan of approximately \$15 million equivalent to Orient Express Bank to provide it with a combination of long and short term funding.
ZAO Raiffeisenbank	75	Financial sector	IFC investment will make up \$75 million. The funding will allow ZAO Raiffeisenbank to expand finance to small and medium enterprises, and municipalities. The investment will be complemented with the EBRD seven-year financing of \$50 million.
Tajikistan			
SEF Tajero II	1.7	Trade	IFC to provide up to \$1.7 million to replenish working capital of the Company. The project's total cost is estimated at \$2.9 million.
IMON SL 2	5	Financial sector	A senior loan in the amount of \$5 million (in national currency) to Imon International microfinance organisation. This is IFC's first loan in Somoni.
Uzbekistan			
Sibur	4.2	Production and services	The IFC loan of \$4.2 million will help the Sibur Group of Companies expand its production capacity with a new facility and production line. The project's total cost is \$9.2 million.
Ukraine			
CPLF- Mriya	5	Agribusiness	An IFC five-year senior loan of up to \$5 million loan to Mriya Agro Holding Public Limited to improve the operational processes and resource efficiencies at four out of six sugar plant companies to bring about a reduction in energy consumption, water use and CO ₂ emissions. The total project cost is \$12.5 million.

Project	Total (\$ million)	Sector	Note
Asnova IV	15	Trade	The total project cost is estimated at \$30.8 million. The proposed IFC financing is a \$10 million A-Loan for IFC's account and a \$5 million quasi-equity investment in LLC Savservice Centre. The project comprises: expansion of Savservice through acquisition of P&G distribution rights in Eastern Ukraine; and investment in working capital needs of its subsidiaries - LLC Savservice-Stolitsa; LLC Savservice-Shid; and LLC Savservice Karpathy.
Bayer Ukraine CA	17.5	Agribusiness	IFC and Credit Agricole's subsidiary in Ukraine have developed a risk-sharing facility that will cover up to \$35 million of seasonal payment obligations to Bayer, the Ukrainian subsidiary of the international chemical and pharmaceutical company. IFC will share 50% of credit losses in the portfolio with the Bank up to a maximum IFC exposure of up to \$17.5 million equivalent in the local currency. The facility will enable farmers to buy crop protection products - including pesticides and herbicides - on credit from industry leader Bayer.
CEB Ukraine	15	Financial sector	A \$15 million senior loan to PJSC Credit Europe Bank (CEB Ukraine), which would be used by the Bank for expansion of its SMEs lending operations and financing energy efficiency projects.
Nibulon Grain	50	Agribusiness	A \$30 million long-term loan to Nibulon Ltd to help the company expand its grain storage infrastructure, and a \$20 million loan to finance the working capital of the company and refinance the existing credit lines.
Astarta	50	Agribusiness	IFC financing will support the construction of a 700-tonnes-per-day soybean crushing facility; construction of a biogas facility; expansion of agricultural land; purchase of supporting farm machinery, and further modernisation of Astarta's sugar production and storage capacity. IFC will provide corporate financing to Astarta in the form of an up to \$50 million long-term loan.

IBRD/IDA*Sovereign loans and grants:*

Project	Total (\$ million)	Sector	Note
Armenia			
Energy Efficiency Project	1.8	Energy efficiency	A \$1.82 million grant from the Global Environment Facility (GEF) Trust Fund for the Energy Efficiency Project for Armenia. The project will support energy efficiency investments in schools, kindergartens, hospitals, administrative buildings, and street lighting. The total cost of the project makes up \$10.64 million.
Municipal Water Project	15	Municipal and other infrastructure	Investment in Armenian Water and Sewerage Company will support improvement of the quality and availability of water supply, including the design, implementation and supervision of the rehabilitation of water systems in the cities of Masis, Echmiadzin, and Ashtarak, and their neighbouring rural settlements. Another \$3 million will be allocated from the Company's own funds.
Third Additional Financing for Social Investment Fund III Project	11	Social sector	The project's total cost is \$14.61 million. The third additional financing will primarily scale-up activities under community investments in support of small-scale, labour-intensive community infrastructure micro-projects. Continued support for ASIF III will provide immediate employment and additional incomes to poor and vulnerable groups.
Third Development Policy Operation (DPO-3)	80	Public administration	The DPO-3 in the amount of \$80 million supports a reform programme to improve access and quality of basic social services for pre-school and hospital services. The programme also supports measures to establish a one-stop shop for business registry, amendments to the Law on Inspections to reduce discretion and increase transparency, introducing a fully functioning green channel by default for customs clearance, and issuing regulations to implement the new mining code to enhance investments.
Tax Administration Modernisation Project	12	Public administration	The development objective of the Tax Administration Modernisation Project for Armenia is to modernise Armenia's tax administration in order to increase voluntary tax compliance, reduce tax evasion, reduce compliance costs, and increase administrative efficiency. The project's total cost amounts to \$15.1 million. The IDA will provide a sovereign loan of \$12 million with the government of Armenia supplying the balance.
Azerbaijan			
SECO Trust Fund	4	Financial sector	An IDA grant to the Central Bank of Azerbaijan.
Second Rural Investment Project	30	Social sector	The development objective of the Second Rural Investment Project for Azerbaijan is to improve access to and use of community-driven rural infrastructure and expand economic activities for rural households. The total project cost makes up \$53.6 million with an IBRD sovereign loan of \$30 million, \$20 million provided by the government of Azerbaijan and the remaining \$3.6 million – by local beneficiaries.

Project	Total (\$ million)	Sector	Note
Kazakhstan			
CAREC - 1b	1068	Transport and transport infrastructure	The upgrade and construction of the Almaty-Khorgos road section of the Western Europe-Western China road corridor (CAREC - 1b) within Almaty Oblast.
Kyrgyzstan			
Effective Local Governance	1.61	Public administration	A \$1.61 million grant to improve the efficiency of local government in Kyrgyzstan.
KG Financial Sector Development Project	13	Financial sector	IDA grant of \$5.85 million equivalent and IDA credit of \$7.15 million equivalent improve the legal, regulatory, and supervisory framework for the banking sector, and transform Kyrgyz Post Office's (KPO) existing operation into a more cost effective distribution channel for basic financial services. The funds will also be used to help Aiyl Bank to improve its governance and financial performance through privatisation and deposit mobilisation.
AF - BISHKEK & OSH URBAN	15.8	Municipal and other infrastructure	The total cost of the project is estimated at \$18.66 million. The objective of the Additional Financing (AF) for the Bishkek and Osh Urban Infrastructure Project is to improve the living conditions in selected semi-informal settlements (novostroiki) in Bishkek and Osh by increasing the availability of basic infrastructure to the residents of these areas.
UNCCD NAP	0.15	Public administration	The total project cost is \$0.37 million, including a \$0.15 million WB grant from the GEF Secretariat as an implementing agency.
Additional Financing for the Second Village Investment Project	4.2	Municipal and other infrastructure	An Additional Financing in the amount of \$4.2 million will help to upgrade infrastructure, such as bridges, water pipeline networks, and water intake facilities. The project is supported by the IDA grant of \$15 million and DfID grant of \$13.2 million. The objective of the project is to improve governance and capacity at the local level; strengthen the provision of and access to essential infrastructure services; and support private group-owned small-scale enterprise development.
Moldova			
Quality Education in the Rural Areas of Moldova AF	1	Education	The Additional Financing for the Quality Education in the Rural Areas of Moldova Project is to assist in improving the quality of education in the rural areas in Moldova under the Government of Moldova's education reform programme.
Education Reform Project	29	Education	The project for implementing the education system reform.
Agriculture Competitiveness Project	18	Agribusiness	A sovereign loan of \$18 million and a \$4.44 million grant to enhance the competitiveness of the agro-food sector by supporting the modernisation of the food safety management system and facilitating market access for farmers.
GEF	4.44	Agribusiness	

Project	Total (\$ million)	Sector	Note
Competitiveness Development Policy Operation	30	Public administration	The programme's objective is to improve competitiveness and increase the volume of Moldovan exports, especially in EU markets and contribute to improved access to finance thereby promoting investment-led growth.
<i>Russia</i>			
Russia Forest Fire Response Project	40	Environment	The Forest Fire Response Project, with an overall budget of \$121.26 million aims to improve forest fire prevention and management and to enhance sustainable forest management. The IBRD commitment to this project stands at \$40 million.
<i>Tajikistan</i>			
AF Land Registration & Cadastre System for Sustainable Agriculture Project	10	Agribusiness	The objective of the Additional Financing for the Land Registration and Cadastre System for Sustainable Agriculture Project for Tajikistan is to expand farmland restructuring activities under the Farm Privatisation Support Project, and to enable more rural people to become independent farmers and take management decisions in response to market forces.
AF ENERGY LOSS REDUCTION	18	Power industry	An \$18 million additional financing for the Energy Loss Reduction Project will assist in the viability assessment of the proposed Rogun Hydropower Project in Tajikistan.
Private Sector Competitiveness	10	Public administration	The objective of the Private Sector Competitiveness Project for Tajikistan is to remove key constraints to business development and investment by simplifying business registration and construction permitting processes; improving regulations and infrastructure underlying access to financial services, and encouraging development of the mining industry.
Additional Financing Municipal Infrastructure	11.85	Municipal and other infrastructure	The development objective of the Project is to improve the availability, quality and efficiency of basic municipal services. An additional grant of SDR7.7 million (\$11.85 million equivalent) will be provided to the project for modernising infrastructure in eight participating towns through financing the rehabilitation and repair of infrastructure and installations and the replacement of equipment of local branches of the State Unitary Enterprise Khojagiyi Manziliyu Kommunal.
Accounting Reform Project	2.4	Public administration	The grant funds will be used to reform the accountancy sector of Tajikistan's financial system.
PDPG6	20	Public administration	The development objective of the Sixth Programmatic Development Policy Grant Programme (PDPG6) for Tajikistan is to protect basic services within a sustainable fiscal framework, and to lay the foundation for post-crisis recovery and growth.
Tax administration reform	18	Public administration	The funds will be channelled to support the reformation of Tajikistan's tax system.

Project	Total (\$ million)	Sector	Note
Second Public Employment for Sustainable Agriculture and Water Resources Management Project	18	Municipal and other infrastructure	An \$18 million IDA grant will be spent on rehabilitation of important irrigation and drainage infrastructure. The project's total cost is \$45.9 million.
Uzbekistan			
Advanced Electricity Metering Project	180	Power industry	The Project's development objective is to reduce the commercial losses by Uzbekenergo's three regional power distribution companies.
The Alat and Karakul Water Supply Project	82	Municipal and other infrastructure	The Alat and Karakul Water Supply Project will improve the coverage, quality and efficiency of the public water supply service in Bukhara region's Alat and Karakul districts.
Second Rural Enterprise Support Project (RESP)	40	Municipal and other infrastructure	The development objective of the RESP is to increase the productivity and financial and environmental sustainability of agriculture and the profitability of agribusiness in the project area. The additional credit will support the scaling-up of the original project's credit line for loans and leases, by providing funds through selected participating financial institutions for investment and working capital sub-loans and lease financings to beneficiaries.
Ukraine			
DEVSTAT Additional Financing	10	Public administration	The funds will be used to create economic statistics models for the State Statistical Committee of Ukraine.
Second Roads and Safety Improvement Project (RSIP)	450	Transport and transport infrastructure	The objectives of the RSIP are an improved condition and quality of sections of the M-03 road and increased safety on roads in Ukraine. There are three components to the project. The first component is road rehabilitation. This component will finance the rehabilitation and upgrading of the M-03 road between Lubny and Poltava. The civil works to be funded from the loan will cover about 108km. Physical works will include the rehabilitation of the existing 4-lane road sections and the widening of other sections from two to four lanes.

NIB

Investment project financing:

Project	Total (\$ million)	Sector	Note
Belarus			
Ecological infrastructure of Grodno and Brest	33.11	Environment	A loan aimed at the reconstruction and upgrade of wastewater treatment plants in the cities of Grodno and Brest. The projects in Grodno and Brest have been prepared in cooperation with the EBRD.
Russia			
OJSC MegaFon	100.99	Telecommunications sector	A 7-year €80 million loan to MegaFon for improvement of the network performance, energy efficiency and reduction of the operation costs.
Petrozavodsk Communal Utilities Systems	9.03	Municipal and other infrastructure	A ten-year loan of 300 million roubles (€7 million) will be used to finance the rehabilitation and improvements of facilities for water supply and wastewater treatment in the city of Petrozavodsk. The investment programme is being carried out by Petrozavodsk Communal Utilities Systems (PKS). In financing the programme, NIB joins a group of international financial institutions led by the Nordic Environmental Finance Corporation NEFCO.
TGK-1	39.74	Power industry	A loan to finance the investment programme, including the reconstruction of Svetogorsk and Lesogorsk HPPs along the River Vuoksi in Leningrad Oblast.

BSTDB*Investment project financing:*

Project	Total (\$ million)	Sector	Note
Azerbaijan			
Azer-Turk Bank	3	Financial sector	A five-year loan to support Azer-Turk Bank's activities in financing eligible SMEs in Azerbaijan.
UNIBANK	5	Financial sector	The \$5 million medium-term SME Facility to support Unibank's activities in financing eligible SMEs in Azerbaijan.
Business Centre in Baku, Azerbaijan	22	Municipal and other infrastructure	A \$22 million loan to Demirchi Development LLC, member of AGA Group, Azerbaijan to support the construction of Demirchi Business Centre in Baku. The maturity of the loan is seven years. The 25-floor Demirchi Business Centre will offer 18,800 m ² of office area and 240 parking lots. The construction is due to be completed in 2013.
Armenia			
Corporate loan to GNC-Alfa CJSC	20	Telecommunications sector	An eight-year loan to GNC-Alfa CJSC will support the further development and expansion of a country-wide broadband access network, enabling the company to provide for triple play services (internet, IPTV and telephone).
Mortgage Financing	8	Financial sector	A 7-year \$8 million loan to Ardashinvestbank CJS exclusively for the purpose of financing/refinancing residential mortgage loans.
Meat Producer	1.4	Agribusiness	Restructuring of a \$7 million loan to CJSC "Natfood" signed in 2008 and provision of additional working capital facility in the amount of up to \$1.4 million. The restructuring would allow the Company to complete installing modern meat processing lines and to start producing high quality meat products for the Armenian market and for export.
Moldova			
Glass Container Prim	3	Production and services	A \$3 million loan to Moldovan Joint Venture Glass Container Prim JSC. The eight-year loan will finance the expansion of production of high quality glass containers and will also help restructure the Company's debt. The BSTDB loan is extended in parallel with a \$10 million facility provided by the IFC, following combined \$16.3 million debt-equity swaps by the company's main shareholders.

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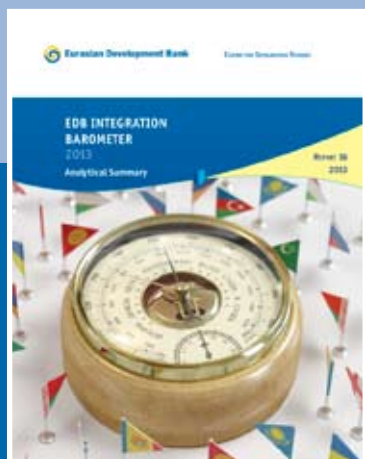
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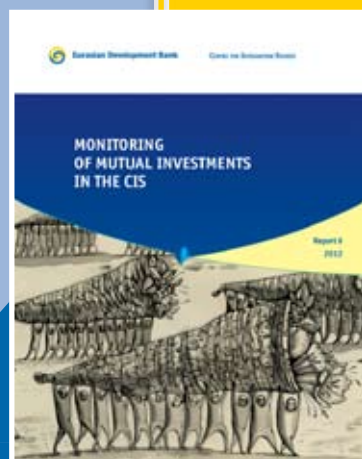


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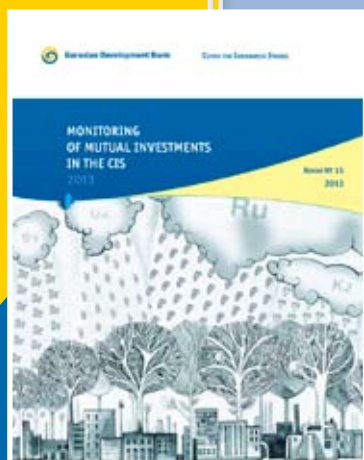
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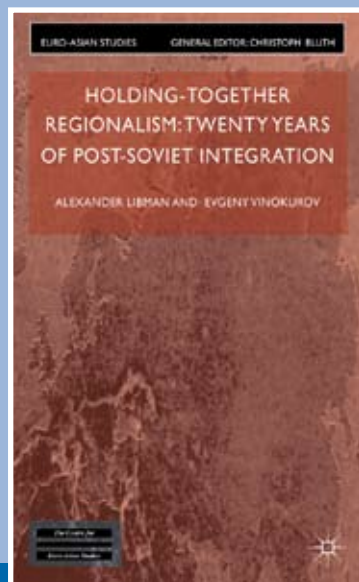


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